INDEX

	Page
Chronological List of Relevant Docket Entries	—1—
Amended Complaint, Filed January 27, 1971	—4—
Exhibit "A" to Amended Complaint:	
Consent Decree in *United States v. Blue Chip Stamp Company*, et al., Entered June 5, 1967	—23—
Exhibit "B" to Amended Complaint:	
Order Approving Plan of Reorganization, Filed October 13, 1967	—36—
Plan of Reorganization of Blue Chip Stamp Company, and	—40—
July 31, 1967, Letter from Counsel for Blue Chip Stamp Company to Chief, Los Angeles Office, Antitrust Division	—52—
Exhibit "C" to Amended Complaint:	
Prospectus Dated August 29, 1968	—55—
Exhibit "D" to Amended Complaint:	
Preliminary Prospectus Dated November 10, 1969	—91—
District Court Opinion and Order Granting Defendants' Motions to Dismiss, Filed May 25, 1971	—123—
Notice of Appeal, Filed June 17, 1971	—132—
Court of Appeals Opinions, Filed October 15, 1973	—133—
Order Denying Rehearing *in banc* and Modifying Opinions, Filed April 1, 1974	—154—

CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

United States District Court for the Central District of California

November 10, 1970 — Complaint for breach of contract, fraud and misrepresentation filed.

January 27, 1971 — Amended complaint for breach of contract, fraud and misrepresentation filed.

March 5, 1971 — Notice of motion to dismiss and memorandum of points and authorities of defendant Market Basket filed; notice of motion to dismiss and memorandum of points and authorities of other defendants filed.

March 24, 1971 — Plaintiff's memorandum of points and authorities in opposition to motions to dismiss filed.

March 31, 1971 — Reply memorandum of defendant Market Basket in support of motion to dismiss filed; reply memorandum of other defendants in support of motion to dismiss filed.

May 25, 1971 — District Court opinion and order granting defendants' motions to dismiss filed.

June 17, 1971 — Plaintiff's notice of appeal filed.

United States Court of Appeals for the Ninth Circuit

November 11, 1971 — Appellant's opening brief filed.

December 13, 1971 — Appellees' brief filed.

January 10, 1972 — Appellant's reply brief filed.

March 2, 1972 — Argued and submitted to Judges Browning, Hufstedler and Choy.

March 17, 1972 — Submission vacated and SEC invited to file brief *amicus curiae.*

May 3, 1972 — SEC *amicus* brief filed.

May 23, 1972 — Appellees' brief in reply to SEC filed.

May 26, 1972 — Appellant's brief joining in SEC *amicus* brief filed.

June 8, 1972 — SEC letter in reply to appellees' reply brief received.

June 23, 1972 — Appellees' letter in response to SEC letter received.

July 13, 1972 — Appellees' letter calling attention to *Mount Clemens Industries, Inc. v. Bell* decision received.

July 20, 1972 — Order entered requesting briefs on *Mount Clemens.*

August 14, 1972 — Appellees' memorandum respecting *Mount Clemens* received; SEC's memorandum respecting *Mount Clemens* received.

August 16, 1972 — Appellant's supplemental brief *re Mount Clemens* filed.

August 24, 1972 — Appellees' letter *re* appellant's supplemental brief received.

September 13, 1972 — Appellees' reply to appellant's supplemental brief filed.

October 15, 1973 — Opinions of the Court of Appeals for the Ninth Circuit and judgment filed and entered.

October 29, 1973 — Order staying mandate and extending time to petition for rehearing *in banc* entered.

November 5, 1973 — Petition for rehearing and suggestion of rehearing *in banc* of appellee Market Basket filed; petition for rehearing and suggestion of rehearing *in banc* of other appellees filed.

January 23, 1974 — Order filed requesting responses to the petitions for rehearing *in banc*.

February 20, 1974 — Appellant's response to petitions filed.

February 21, 1974 — SEC's response to petitions filed.

April 1, 1974 — Order filed modifying majority and dissenting opinions, and denying petitions for rehearing and rejecting suggestion of rehearing *in banc*.

April 10, 1974 — Appellees' motion for stay of issuance of mandate pending petitioning for certiorari filed; stay of mandate ordered until April 18, 1974, to permit application to panel majority.

April 16, 1974 — Order staying mandate until July 1, 1974, filed.

June 21, 1974 — Order of Mr. Justice Douglas entered extending time to petition for certiorari to August 15, 1974.

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[Filed January 27, 1971]

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Manor Drug Stores and all other users of Blue Chip Stamps who were entitled but failed to purchase stock of Blue Chip Stamps, on behalf of themselves and all other persons similarly situated, *Plaintiffs,* vs. Blue Chip Stamps, a corporation, Blue Chip Stamp Company, a merged corporation, Lucky Stores, Inc., Market Basket, a corporation, Purity Stores, Inc., Ralphs Grocery Company, a corporation, Safeway Stores, Inc., Thriftimart, Inc., Thrifty Drug Stores Co., Inc., Vons Grocery Co., a corporation, Robert E. Alexander, Donald A. Koeppel, Leonard H. Straus, William F. Ramsey, Robert E. Laverty, Richard Ralphs, John R. Niven, Fred von der Ahe, *Defendants.*	CIVIL NO. 70-2539-RJK Amended Complaint for Breach of Contract, Fraud and Misrepresentation JURY TRIAL REQUESTED

FIRST CAUSE

I

This action is instituted under the Securities Act of 1933 (15 U.S.C. §§ 77a, *et seq.*); under the Securities Exchange Act of 1934 (15 U.S.C. §§ 77a, *et seq.*); under § 10 of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) and Rule 10b-5 adopted thereunder; under § 12 of the Securities Act of 1933; and jurisdiction is founded on the Securities Act of 1933 (particularly, without limitation, § 22 thereof [15 U.S.C. § 77v]) and the Securities Exchange Act of 1934 (particularly, without limitation, § 27 thereof [15 U.S.C. § 78aa]); and jurisdiction is founded on the doctrine of pendent jurisdiction as to causes arising out of state law.

II

Plaintiff is a corporation duly organized and existing under the laws of the State of California, with its principal place of business in the State of California, and brings this action in its own behalf and as a class action on behalf of others similarly situated in accordance with the provisions of Rule 23 of the Federal Rules of Civil Procedure for the United States District Courts.

III

The persons who constitute the class are so numerous that joinder of all members is impracticable; there are questions of law and fact common to the entire class; the claims of plaintiff are typical of the claims of the entire class and each member thereof; and the plaintiff will thoroughly and adequately protect the interests of the entire class and each member thereof.

IV

Defendants, ALEXANDER'S MARKETS, LUCKY STORES, INC., RALPHS GROCERY COMPANY, THRIFTIMART, INC., MARKET BASKET, and THRIFTY DRUG STORES CO., INC., are corporations, each of which has been organized and is existing under the laws of the State of California; defendant, PURITY STORES, INC., is a corporation organized and existing under the laws of the State of Nevada and is authorized to do business and is doing business in the State of California; defendant, SAFEWAY STORES, INC., is a corporation organized and existing under the laws of the State of Maryland and is authorized to do business and is doing business in the State of California; defendant, VONS GROCERY COMPANY, is a corporation organized and existing under the laws of the State of Delaware and is authorized to do business and is doing business in the State of California. Each of said defendants maintains its principal place of business in the County of Los Angeles, State of California, with the exception of LUCKY STORES, INC., which has its principal place of business in the County of Alameda, State of California, PURITY STORES, INC., which has its principal place of business in the County of San Mateo, State of California, and SAFEWAY STORES, INC., which has its principal place of business in the County of Alameda, State of California.

The said corporate defendants listed in this Paragraph IV were stockholders of BLUE CHIP STAMPS at the time of the offering hereinafter described and owned approximately ninety percent (90%) of its stock at said time.

V

Defendants, ROBERT E. ALEXANDER, DONALD A. KOEPPEL, FRED VON DER AHE, LEONARD H. STRAUS, DRUMMOND WILDE, WILLIAM H. DYER, JR., ROBERT E. LAVERTY, WILLIAM F. RAMSEY, and RICHARD RALPHS, are now and were at all times from the time of its incorporation in about July 1968, members of the Board of Directors of BLUE CHIP STAMPS. At all of said times defendant, ROBERT E. ALEXANDER, represented the interests of defendant, ALEXANDER MARKETS, on said board; defendant, FRED VON DER AHE, represented the interests of defendant, VONS GROCERY CO., on said board; defendant, LEONARD H. STRAUS, represented the interests of defendant, THRIFTY DRUG STORES CO., INC., on said board; defendant, DRUMMOND WILDE, represented the interests of defendant, SAFEWAY STORES, INC., on said board; defendant, WILLIAM H. DYER, JR., represented the interests of defendant, LUCKY STORES, INC., on said board; defendant, ROBERT E. LAVERTY, represented the interests of defendant, THRIFTIMART, INC., on said board; defendant, RICHARD RALPHS, represented the interests of defendant, RALPHS GROCERY COMPANY, on said board; and defendant, JOHN R. NIVEN, represented the interests of defendant, PURITY STORES, INC., on said board.

VI

In connection with and in furtherance of and as an integral part of the illegal and fraudulent scheme herein alleged, defendants directly and indirectly, by the use of the means and instrumentalities of transportation and communication in interstate commerce and by the use of

the mails, engaged in acts, practices, courses of business and manipulative and deceptive devices, all constituting and operating as a fraud and deceit upon the plaintiffs as untrue and misleading statements of material facts and omission of material facts, which were intended to, and did, defraud plaintiffs.

In December, 1963, the United States of America, as plaintiff, filed in the United States District Court, Central Division of California, an action against Blue Chip Stamp Co. and nine of its twelve stockholders, including all of the corporations named as defendants herein except the defendant, Blue Chip Stamps, which was not then in existence, charging violations under the Sherman Anti-Trust Act, said action being entitled United States of America, plaintiff vs. Blue Chip Stamp Co., et al., defendants, bearing civil action No. 63-1552-F, which action is sometimes hereinafter referred to as the "Government Case."

As a result of said action, a Consent Final Judgment (sometimes herein referred to as "Consent Decree") was made and entered by the United States District Court on or about June 5, 1967, which, among other things, provided that the defendant corporations present to the Court for its approval a plan for the reorganization of Blue Chip Stamp Co. A true copy of said Consent Decree is attached hereto as Exhibit "A" hereof and incorporated herein.

Pursuant to said Consent Decree, said defendant corporation submitted to the Court a plan of reorganization of Blue Chip Stamp Co., which plan was thereafter approved by said Court and incorporated into said Final Consent Decree. A true copy of said plan of reorganization and order approving said plan is attached hereto with certain conditions as Exhibit "B" hereof and incor-

porated herein, and is sometimes hereinafter referred to as "The Plan."

The Plan required among other things the formation of a "new company," which was later named BLUE CHIP STAMPS, one of the defendants herein, and required the merger of defendant Blue Chip Stamp Co. into said BLUE CHIP STAMPS.

VII

Among the provisions of The Plan was the following:

"An offering of approximately 621,600 shares of its common stock would then be made by New Company (defendant BLUE CHIP STAMPS) to users of BLUE CHIP STAMPS (who issue stamps to their retail customers as a reward for patronage) other than users who are also shareholders of BLUE CHIP (such users to whom such offering is to be made are hereinafter referred to as "Users") on a pro rata basis determined by the quantity of stamp pads issued to Users during the period subsequent to March 1, 1964, and prior to a date to be determined which will be not more than ninety (90) days prior to the effective date of registration statement hereinafter referred to. The offering will be made in units consisting of three (3) shares of the common stock of New Company (defendant BLUE CHIP STAMPS) and one (1) One Hundred Dollars ($100.00) principal amount debenture for a cash consideration of One Hundred One Dollars ($101.00)."

VIII

Said Consent Decree further provided that in the event all of said 621,600 shares were not purchased by the Users the defendant, BLUE CHIP STAMPS, would be per-

mitted to sell the shares not so purchased at the then reasonable market value of said shares.

The above provisions of The Plan were included for the purpose of complying with the Court's direction that the defendants divest themselves of a total of about fifty-five percent (55%) of their holdings in the reorganization of the defendant, BLUE CHIP STAMP COMPANY, by its merger into BLUE CHIP STAMPS.

IX

Among the parties appearing in said Government case were the Attorney General of the State of California in behalf of Users other than Users who were also stockholders of BLUE CHIP STAMP COMPANY, and several users individually and in trade association.

All of said Users in this paragraph contended before the Court that they, in fact, owned an interest in the defendant, BLUE CHIP STAMP COMPANY, and the Twenty Million Dollars ($20,000,000) in profits it had accumulated during the five (5) years immediately prior thereto, and that in any decision of the said government case, the ownership of said users of an interest in the said defendant, BLUE CHIP STAMP COMPANY, and BLUE CHIP STAMPS should be decreed.

X

The claims and contentions by and on behalf of the users, as aforesaid, prompted the provisions of The Plan and the offering of three (3) shares of common stock and one (1) One Hundred Dollars ($100.00) principal amount debenture (hereinafter sometimes referred to as a "Unit") to the users for a cash consideration of One Hundred One Dollars ($101.00) which offering was a

bargain, was intended by the Court in the government case as a bargain, was recognized by the defendants herein as a bargain, and was intended by the United States of America, as plaintiff in the Government case and was, in fact, a bargain. It was the purpose and intent of the said Consent Decree and The Plan that the Users as described therein would benefit from the bargain purchase provided in the said Court Decree and Plan.

XI

The reasonable market value of the said Units at the time of the offering that was made pursuant to The Plan was, and still is, at least Three Hundred Fifteen Dollars ($315.00), of which Seventy-Five Dollars ($75.00) represented the reasonable market value of one (1) debenture and Eighty Dollars ($80.00) the reasonable market value of one (1) share of stock. The net bargain provided by said offering was, therefore, approximately $71.33 per share or $214.00 per unit.

XII

In compliance with said Consent Decree and The Plan, the defendant, BLUE CHIP STAMPS ("New Company") was formed in about July, 1968, and issued 621,000 [sic.] shares of stock to the stockholders of BLUE CHIP STAMPS COMPANY (of which approximately 560,000 shares went to the defendants herein); 27,600 shares were reserved for offering to certain of its employees; 10,400 [sic.] shares were reserved for issuance pursuant to its qualified Stock Option Plan; and an additional 621,000 [sic.] shares were earmarked for offering to the Users of Blue Chip Stamps, including plaintiffs, pursuant to The Plan as set forth above.

Under the said Consent Decree and The Plan plaintiffs, as Users, were entitled to purchase approximately 100,000 Units or 300,000 shares of the 621,600 shares of defendant, BLUE CHIP STAMPS. Said units, as hereinabove alleged, in fact, being offered at One Hundred One Dollars ($101.00) each when they were worth, and known by the defendants to be worth, Three Hundred Fifteen Dollars ($315.00) per unit.

Under the said Consent Decree and The Plan, all of the members of the class suing herein, who failed to purchase said Units by reason of the facts set forth herein, were entitled to purchase the said 100,000 Units. That by not purchasing said Units at said price of One Hundred One Dollars ($101.00) per Unit, they were damaged in the amount of Twenty-One Million Four Hundred Thousand Dollars ($21,400,000.00).

XIII

As part of and pursuant to the said Consent Decree and The Plan, the defendants used the mails and other instrumentalities of inter-state commerce and caused defendant, BLUE CHIP STAMPS, to make the offering described above to the Users, including plaintiffs, of securities in Units described above through a certain Prospectus dated August 29, 1968 (hereinafter sometimes referred to as the Negative Prospectus), prepared and transmitted through the United States mail and other instrumentalities of inter-state commerce by the defendants in the name of the defendant, BLUE CHIP STAMPS. A true copy of said Prospectus is annexed hereto as Exhibit "C" and made a part hereof. Said Negative Prospectus and accompanying documents required the Users, including plaintiffs, to exercise their rights on or before November 29, 1968. At no time after said offering and neither before

nor after November 29, 1968, did defendants disclose to plaintiffs the true facts with respect to the value of said securities as herein set forth.

XIV

Defendants and each of them desired that the Users fail to exercise their rights under said Consent Decree, Plan and Prospectus to purchase the shares to which they were entitled, and, pursuant to said desire, said defendants, and each of them, conspired among themselves to accomplish said purpose, and said defendants, and each of them, did accomplish said purpose, by preparing and using said Prospectus as a manipulative and deceptive device and contrivance calculated to mislead and dissuade users not knowledgeable of the true value of said shares from purchasing said shares. That said Prospectus was employed as a device, scheme, and artifice to defraud the users, and said defendants, and each of them, were thereby engaged in an act, practice and course of business which operated and was intended to operate as a fraud and deceit upon the users in connection with the purchase of said shares. More specifically, said Prospectus, prepared as aforesaid, provided in part as follows:

(a) Commencing on page one in the fifth line thereof, defendants called attention to five "Items of Special Interests" appearing on page 2, all of which were negative and designed to mislead the Users, including plaintiff, as to the true value of the stock and thereby to dissuade them from purchasing, as hereafter set forth. Said "Items of Special Interests" were as follows:

"Prospective purchasers of securities offered herein shall particularly note the following items, each of

which will be or may be adverse and which is discussed later in this Prospectus in greater detail:

(1) Net income from the current fiscal year will be adversely affected by payments aggregating Seven Million Nine Hundred Twenty-Eight Thousand ($7,928,000.00) Dollars made since March 2, 1968, in settlement of claims against the Company (See "Statement of Income and Retained Earnings" and "Litigation").

(2) Net income would be adversely affected by a substantial decrease in the use of Company's trading stamp service (See "Business — General").

(3) Net income would be adversely affected by a sale of one-third of the Company's trading stamp business in California; approximately ninety-nine percent (99%) of the Company's stamp service income is derived from its operations in California (See "Business — Effects of Consent Decree on Company's Operations").

(4) Claims or Causes of Action (as defined) against the Company, including prayers for treble damages, now aggregate approximately $29,000,000. The Company has agreed to indemnify Blue Chip Stamp Company and the present and former officers, directors and stockholders of the Company or Blue Chip Stamp Company from any liability or expenses arising out of certain claims asserted against any of them (See "Litigation").

(5) All but two of the present directors are precluded until June 5, 1977, from serving as directors after the first meeting of the Company's stockholders following the offer herein so long as they are employed by specified companies (See "Management").

Said five "Items of Special Interest" were thereafter referred to individually or collectively approximately fifteen (15) times. Constant reference to said items was intended to, and did cause plaintiffs to be misled as to the true value of said shares. When the defendants themselves did, one year later, offer their own shares to the public at Ninety Dollars ($90.00) per share (allowing for a five-to-one stock split in the interim) by a Prospectus, a copy of which is attached hereto as Exhibit "D" and made a part hereof by reference (hereinafter referred to as "The Positive Prospectus"), no negative "Items of Special Interest" were set forth, nor was there reference to such items, although (to the extent they were relevant at the time of the Negative Prospectus) they were relevant at the time of the Positive Prospectus.

(b) Commencing in the second paragraph on page one of the Negative Prospectus there was reference to "Claims or Causes of Action" against the defendant, BLUE CHIP STAMPS, in the amount of Twenty-Nine Million Dollars ($29,000,000) and reference to said "Claims or Causes of Action" was thereafter repeatedly and unnecessarily made. Such constant reference to said claims was made with the intention to, and it did, cause the plaintiffs to be misled as to the true value of said shares. The Twenty-Nine Million Dollars ($29,000,000) amount of said claims was repeated and emphasized in said Negative Prospectus. Defendants knew that said claims were in fact of insignificant merit and were settled shortly after November 29, 1968, for less than One Million Dollars ($1,000,000.00).

(c) The "Litigation" section of the Negative Prospectus devotes three (3) printed pages to a recount of suits already settled with emphasis on the size of the claims, complexity of the matters, and a de-emphasis of the fact that they had already been settled. The Posi-

tive Prospectus one year later refers to none of these cases by name and covers all of the settlements in two sentences.

(d) No underwriters were employed, no salesmen were used, and the offering was quietly accomplished by one mailing or hand delivery (unless the user filled out an information form requiring time and effort), and one newspaper advertisement in several California newspapers. Plaintiffs had no information as to the number of shares to which they were entitled unless they assembled data for defendants. However, defendants knew or should have known the number of shares each plaintiff was eligible to receive, but failed to disclose this information to plaintiffs.

(e) Plaintiffs were required to purchase their shares on or before November 29, 1968, or lose their rights.

(f) No information concerning the value of the stock was ever supplied to the plaintiffs by defendants except that set forth in the Negative Prospectus.

(g) The Negative Prospectus on Page 10 emphasized the possibility of losing customers and the obvious fact that defendant, BLUE CHIP STAMPS, had no assurance of continued patronage of its customers. The Negative Prospectus de-emphasized the fact that BLUE CHIP STAMPS' patronage undoubtedly would increase because it had been prohibited by the Consent Decree from preventing customers from giving extra stamps as a premium. BLUE CHIP STAMPS' business and profits did, in fact, increase substantially since the date of the Negative Prospectus.

(h) The Negative Prospectus on Page 12 states that the company estimates that Ninety-seven and one-half per cent (97½%) of all stamps issued will be redeemed.

In fact, less than ninety per cent (90%) of all stamps historically are redeemed. Based upon its sales of Ninety Million Dollars ($90,000,000.00) per year, or more, this misrepresentation resulted in an understatement of earnings on stamp sales for the year prior to the offering of Six Million Dollars ($6,000,000) or about eighty per cent (80%).

(i) The Negative Prospectus referred in several places to certain allegedly disadvantageous provisions of the Consent Decree or Plan in a negative manner designed to dissuade Users from exercising their rights under the said offering, and said Prospectus concealed from the Users, including plaintiffs, the fact that said Consent Decree would be highly beneficial to BLUE CHIP STAMPS in that its provisions were certain to, and did, force practically all competitors out of the State of California and that BLUE CHIP STAMPS and buyers of its Units would accordingly benefit thereby.

XV

The entire offering, as set forth in the Negative Prospectus, including but not limited to the provisions in said offering, as set forth in subparagraphs (a), (b), (c), (g), (h) and (i) of the last preceding paragraph of this pleading, resulted in the misrepresentation of material facts and the withholding of material information and was seriously misleading and was intended by defendants to be misleading in the light of all of the facts. The said offering did, in fact, mislead the plaintiffs in that they did not realize the real value of the Units being offered to them.

XVI

Relying upon said representations contained in the Prospectus, the plaintiffs, and each of them, were induced and did, in fact, not accept said offer and purchase said Units. Over 60% of the Users who purchased said Units had information outside and independent of said Negative Prospectus.

XVII

Under the said Consent Decree and The Plan, all of the members of the class suing herein, who failed to purchase said Units by reason of the facts set forth herein, were entitled to purchase the said Three Hundred Thousand (300,000) shares; that by not purchasing said shares at said price of Eight Dollars and Sixty-Seven Cents ($8.67) per share, they were damaged in the amount of Twenty-One Million Four Hundred Thousand Dollars ($21,400,000).

XVIII

Each of the defendants deliberately acted as hereinabove alleged for the purpose of benefiting themselves at the expense and to the damage of plaintiffs and each of them, and were thereby guilty of oppression, fraud and malice, whereby plaintiffs, and each of them, in addition to the actual damages hereinabove alleged, should recover damages for the sake of example and by way of punishing the defendants, and each of them.

SECOND CAUSE

I

Plaintiffs repeat and reallege each and all of the allegations of the First Cause with the same force and effect as if the same were here set forth in full.

II

The aforesaid misleading and false representations were made by defendants with the intent to induce plaintiffs to refrain from purchasing said offered shares of New Company in order that defendants would materially benefit from such failure of purchase on the part of prospective purchasers.

III

The aforesaid representations made by defendants were, at the time they were made and subsequent thereto, known to the defendants to be false and misleading.

IV

Plaintiffs, and each of them, at the time said representations were made and subsequent thereto, were ignorant of their false and misleading nature and believed them to be true and accurate. In reasonable reliance thereon, plaintiffs were induced to and did in fact refrain from accepting said offer; had plaintiffs known the true facts they would have accepted said offer and benefited from said "bargain sale."

V

By reason of said false and misleading representations by the defendants, and plaintiffs' reliance thereon, plaintiffs have been damaged in the amount of $21,400,000.

THIRD CAUSE

I

Plaintiffs repeat and reallege each and all of the allegations of their First Cause and Paragraph II of their Second Cause with the same force and effect as if the same were here set forth in full.

II

When defendants made said false and misleading representations, they had no sufficient or reasonable ground for believing them to be true.

III

Plaintiffs, and each of them, at the time said representations were made and subsequent thereto, were ignorant of their false and misleading nature and believed them to be true and accurate. In reasonable reliance thereon, plaintiffs were induced to and did in fact refrain from accepting said offer; had plaintiffs known the true facts they would have accepted said offer and benefited from said "bargain sale."

IV

By reason of said false and misleading representations by the defendants, and plaintiffs' reliance thereon, plaintiffs have been damaged in the amount of $21,400,000.

FOURTH CAUSE

I

Plaintiffs repeat and reallege each and every allegation of their First Cause with the same force and effect as if the same were here set forth in full.

II

The plaintiffs, and each of them, were the express intended beneficiaries of said final consent judgment entered into between the plaintiffs and defendants of [sic.] said prior proceedings and approved by the Court.

III

The aforesaid final consent judgment stated that defendants planned a reorganization of the BLUE CHIP STAMP COMPANY including a method of divestiture of defendants' holdings in said company which was to be conducted and effected in good faith by defendants.

IV

Defendants' aforesaid false and misleading misrepresentations were a violation of the Court imposed duty of good faith and constituted a breach of said Final Consent Judgment.

V

As a direct and proximate result of defendants' breach of said Final Consent Judgment, plaintiffs were damaged in the amount of Twenty-One Million Four Hundred Thousand ($21,400,000.00) Dollars.

WHEREFORE, plaintiffs pray judgment against the defendants as follows:

1. For damages in the amount of Twenty-One Million Four Hundred Thousand ($21,400,000.00) Dollars;

2. The right to purchase shares of stock or units of Blue Chip Stamps on the price and terms offered in the 1968 offering;

3. For exemplary damages in the amount of Twenty-Five Million ($25,000,000.00) Dollars;

4. For interest;

5. For attorneys' fees for the representation of plaintiffs herein;

6. For cost of suit; and

7. For all proper relief.

Dated January 26, 1971.

J. J. BRANDLIN, JAMES E. RYAN and RAY E. MCALLISTER

By /s/ J. J. BRANDLIN

J. J. BRANDLIN

Jury trial requested.

J. J. BRANDLIN, JAMES E. RYAN and RAY E. MCALLISTER

By /s/ J. J. BRANDLIN

J. J. BRANDLIN

[Exhibit "A" to Amended Complaint]

[Filed June 5, 1967]

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, *Plaintiff,* v. BLUE CHIP STAMP COMPANY; ALEXANDER'S MARKETS; LUCKY STORES, INC.; MARKET BASKET; PURITY STORES, INC.; RALPHS GROCERY COMPANY; SAFEWAY STORES, INCORPORATED; THRIFTIMART, INC.; THIFTY DRUG STORES CO., INC.; and VON'S GROCERY CO. *Defendants.*	CIVIL ACTION NO. 63-1552-F ENTERED:

FINAL JUDGMENT

Plaintiff, United States of America, having filed its complaint in the United States District Court for the Southern District of California, Central Division, on December 26, 1963; each of the defendants having appeared and filed its answer denying the substantive allegations thereof; and the plaintiff and the defendants, by their attorneys, having severally consented to the entry of this Final Judgment without trial or adjudication of any issue of fact or law herein, without the taking of any evidence, and without this Final Judgment constituting any evidence or admission by any party in respect to any issue of fact or law herein;

NOW, THEREFORE, before the taking of any testimony and without trial or adjudication of any issue of fact or law herein and upon the consent of the parties hereto, it is hereby

ORDERED, ADJUDGED AND DECREED as follows:

I.

This Court has jurisdiction of the subject matter of this action and of the parties consenting hereto. The complaint states claims for relief against the defendants under Sections 1 and 2 of the Act of Congress of July 2, 1890, as amended, entitled "An Act to protect trade and commerce against unlawful restraint and monopolies," commonly known as the Sherman Act.

II.

For the purposes of this Final Judgment:

(A) "Person" shall mean an individual, partnership, firm, association, corporation or other legal or business entity;

(B) "Trading stamp business" shall mean the distribution for compensation, of trading stamps to any person for issuance to its customers, employees or others, and the redemption of said stamps for merchandise or money;

(C) "Trading stamp company" shall mean a person engaged in the trading stamp business;

(D) "Capital Assets" shall mean land, buildings, leasehold improvements, furniture and fixtures, warehouse equipment, delivery equipment and automobiles.

(E) "Southern California" is that part of California south of the line formed by the northern boundaries

of San Luis Obispo, Kern and San Bernardino Counties.

(F) "New Blue Chip" shall mean a purchaser of, or any other successor to, Blue Chip's trading stamp business pursuant to Section VI herein or a reorganized company pursuant to Sections V or VII herein.

(G) "Reorganization" shall mean a reconstitution of the stock structure of Blue Chip and shall include the creation of a new company to which the assets and liabilities of Blue Chip are transferred, or into which Blue Chip is consolidated or merged.

III.

The provisions of this Final Judgment applicable to any defendant and any person agreeing to be bound shall also apply to each of its subsidiaries, successors, assigns, officers, directors, and employees, and to all other persons in active concert or participation with such defendant or persons who shall have received actual notice of this Final Judgment by personal service or otherwise, but shall not apply to transactions solely between or among such defendant or person and its officers, directors, employees, parent company, subsidiaries and affiliates, or any of them.

IV.

Each of the retailer defendants is enjoined and restrained from:

(A) Combining or conspiring to restrain trade in, or monopolizing or attempting to monopolize the trading stamp business in the State of California; or carrying out, directly or indirectly, any such combina-

tion, conspiracy, attempt to monopolize or monopolization;

(B) Entering into any contract, agreement or understanding with any other user of trading stamps in the same line of business:

(i) To refrain, in the State of California or in particular areas thereof, from using trading stamp services entirely or from using the trading stamp services of any particular person or persons; or

(ii) To limit the rate of issue employed in distributing trading stamps to their respective customers in such state;

(C) Acting jointly with any other user of trading stamp services in the same line of business to organize or acquire a trading stamp company to operate in the State of California except as provided in Sections V, VI or VII hereof.

Provided, that this Section IV shall not apply to a retailer defendant, acting independently: (i) in obtaining or entering into any contract to obtain trading stamp services from any trading stamp company; or (ii) when such defendant is engaged in the trading stamp business (either directly or through a subsidiary or affiliate), in furnishing or entering into any contract to furnish trading stamp services to any person, and provided further that this Section IV shall not apply to the provision of trading stamp services by any trading stamp company which is not named as a defendant herein.

V.

Blue Chip is ordered and directed to present to the Court, within 60 days following the date of entry of this Final Judgment, a plan for the reorganization of Blue Chip Stamp Company. The plan shall be substantially in accordance with either of the plans heretofore furnished to plaintiff. Upon approval of the plan by the Court, Blue Chip shall make bona fide and diligent efforts to reorganize the company pursuant to the said plan. If at any time, in plaintiff's judgment, such efforts are not being made, plaintiff may apply to the Court for an order directing that this Section V shall no longer apply. In the event that such order issues, Blue Chip shall be required to divest pursuant to Section VI or to reorganize pursuant to Section VII hereof.

VI.

(A) In the event that Section V becomes inapplicable Blue Chip is ordered and directed to divest, with all due diligence, within 15 months from the date upon which Section V shall no longer apply, all of the company's capital assets, goodwill, and the right to the service mark and to the use of the name "Blue Chip," and, following such divestiture, to discontinue issuance of trading stamps, cease doing business as an operating company and thereafter to wind up its affairs and dissolve consistent with the applicable laws of the State of California.

The divestiture shall be made upon the following terms and conditions:

(1) The purchaser or successor to Blue Chip's trading stamp business shall agree to enter its appearance in this proceeding and shall furnish its written consent

to be bound by the applicable provisions of this Final Judgment.

(2) The purchaser or successor shall agree to engage in the trading stamp business in California for a reasonable period of time.

(3) The purchaser or successor shall contract with Blue Chip on mutually satisfactory terms for the redemption of all outstanding trading stamps theretofore issued by Blue Chip and said contract shall insure discharge of Blue Chip's redemption obligations and shall require the purchaser or successor to redeem its stamps interchangeably with the trading stamps theretofore issued by Blue Chip.

(4) The purchaser or successor shall assume such other obligations as Blue Chip and it may agree and Blue Chip shall transfer such cash, securities or other assets as it and Blue Chip may agree.

The said divestiture may be made by a sale of assets, a sale of stock of a corporation which controls the assets, or in any other manner not otherwise inconsistent with the terms of this decree. Provided, that in the event that all of the stockholders of Blue Chip dispose of their stock to a purchaser or successor said disposal shall be regarded as a divestiture by Blue Chip for the purposes of this Final Judgment.

(B) Blue Chip shall make known the availability of the assets for sale. Blue Chip shall furnish to bona fide prospective purchasers making inquiry to it, such information as is reasonably necessary for them to proceed with negotiations looking toward the ultimate acquisition of the assets to be divested and shall furnish plaintiff concurrently with the name of any such prospective purchaser. Blue Chip shall render quarterly reports to the

Assistant Attorney General in charge of the Antitrust Division concerning its efforts to effectuate the divestiture required, the first such report to be rendered within 30 days of the date that Section V shall no longer apply.

(C) At least 30 days in advance of the closing date specified in any contract for sale, Blue Chip shall supply plaintiff with the name of the proposed purchaser, the purchase contract, and with such other information in its possession as is material to the proposed sale. If plaintiff requests, the said closing date shall be extended to the extent necessary to afford plaintiff 60 days between the date of the receipt of the said information and the closing date. Blue Chip may close any sale unless plaintiff serves upon Blue Chip, at least 15 days in advance of the closing date, written notice that plaintiff objects thereto. If plaintiff serves such written notice with respect to a sale to a purchaser engaged in the trading stamp business, or a purchaser engaged in the operation of retail food stores in the State of California, such sale shall not be closed. If plaintiff serves such written notice with respect to any other sale, the sale shall not be closed unless approved by the Court. The time period set forth in Section VI(A) above shall be tolled during the pendency of any extension or of any proceeding under this Section VI(C).

(D) The divestiture ordered and directed by Section VI(A) of this Final Judgment shall be made in good faith and shall be absolute and unqualified except as follows:

(1) Nothing herein contained shall be deemed to prohibit Blue Chip from retaining, accepting and enforcing a bona fide lien, mortgage, deed of trust or any other form of security reasonably necessary to secure full payment of the price at which the divested property

is disposed of or sold or to secure any other obligation of a purchaser or successor, provided that if Blue Chip shall regain ownership of or control over the property divested as a result of any lien, mortgage, deed of trust, or other undertaking Blue Chip shall be required to terminate such ownership or control within 18 months thereafter.

(2) In the event that Blue Chip receives, as a result of any divestiture hereunder, stock of a corporation which controls the divested assets:

(a) Blue Chip shall be required: (i) to dispose of any amount of such stock in excess of 10% of the outstanding common stock of such corporation within one year following the date of receipt thereof or within 22 months following the date Section V shall no longer apply, whichever is earlier, provided that in no event shall such disposal be required within less than three months following the date of receipt of such excess; and (ii) to dispose of the balance of such stock no later than the date of final distribution in liquidation; and (iii) pending disposal, to cause any voting rights of such stock to be exercised by a financial institution or other third party who is acceptable to plaintiff or approved by the Court; and

(b) In the event Blue Chip distributes such stock to its shareholders, no distribution shall be made pursuant to which any Blue Chip shareholder will retain more than 1% of the outstanding common stock of the said corporation unless the plan of distribution is acceptable to plaintiff or approved by the Court.

VII.

In the event that Section V becomes inapplicable, Blue Chip may also enter into a reorganization pursuant to a plan for the reorganization of Blue Chip Stamp Company acceptable to the Court. The plan shall be substantially in accordance with either of the plans heretofore furnished to plaintiff or in accordance with any other plan acceptable to Blue Chip and to plaintiff.

VIII.

(A) Blue Chip is ordered and directed to continue its trading stamp business and to continue to promote its trading stamp service until completion of the reorganization set forth in Sections V or VII above or until the divestiture set forth in Section VI above. Until such reorganization or divestiture Blue Chip is enjoined and restrained from:

(1) Refusing to provide a trading stamp service or imposing any limitation on such service to any person because of: (i) the presence in the same locality of any establishment operated by another person using Blue Chip's stamp service; (ii) the rate of issue employed by such person in offering Blue Chip's or any other person's stamps; or (iii) the use by such person of any other trading stamp service;

(2) Coercing or compelling any person: (i) to limit the rate of issue employed in offering Blue Chip's or any other person's stamps; or (ii) to refrain from using any other trading stamp service.

(B) New Blue Chip, in the event that it is not already a party hereto, shall enter its appearance in this proceeding and give its consent to be bound by the applicable

provisions of this Final Judgment. A purchaser of assets pursuant to Section IX hereof shall enter its appearance in this proceeding and give its consent to be bound by the applicable provisions of this Final Judgment. New Blue Chip and such purchaser are enjoined and restrained from:

(1) Refusing to provide a trading stamp service or imposing any limitation on such service to any person because of: (i) the presence in the same locality of any establishment operated by another person using the company's stamp service; (ii) the rate of issue employed by such person in offering the company's or any other person's stamps; or (iii) the use by such person of any other trading stamp service;

(2) Coercing or compelling any person (i) to limit the rate of issue employed in offering the company's or any other person's stamps; or (ii) to refrain from using any other trading stamp service;

(3) Having as an officer or employee any person who, while holding such position, also serves as an officer, director, or employee of any person using trading stamp services, or from having, for a period of ten years following the date of entry of this Final Judgment, as a director, any person who, while holding such position, also serves as an officer, director or employee of any person who was a Blue Chip stockholder in 1956 or 1957.

(C) Each of the retailer defendants is enjoined and restrained for a period of ten years following the date of entry of this Final Judgment:

(1) From having as an officer, director, or employee any person who, while holding such position, also serves as an officer, director or employee of New Blue Chip; or

(2) From exercising any right which it might acquire to vote for the election of any official of New Blue Chip; *provided* that a retailer defendant may cause such right to be exercised independently by a financial institution or other third party acceptable to plaintiff or approved by the Court.

Each retailer defendant shall be free to utilize or not utilize the trading stamp services of Blue Chip and New Blue Chip and, except as provided in this Section VIII(C), to exercise the same rights and privileges available to every other user of the stamp services of Blue Chip or New Blue Chip.

IX.

New Blue Chip shall, within 30 months after the date of completion of the reorganization under Sections V or VII above or the divestiture under Section VI above present for the approval of the Court a plan which shall include the following terms:

(1) New Blue Chip shall offer for sale one-third of its then existing trading stamp business in the State of California. The business to be offered for sale shall be located within a contiguous geographic area within Southern California.

(2) A purchaser shall be permitted to acquire the business only upon the condition that it enter its appearance in this proceeding and agree: (i) to be bound by the applicable provisions of Section VIII(B), IX, X and XI of this Final Judgment and (ii) to engage in the trading stamp business for a reasonable period of time. A purchaser shall have the right, if it so elects, to redeem New Blue Chip trading stamps within the contiguous area for the period of one year following

the consummation of the sale. Plaintiff shall have the right to object to a purchaser in the same manner as it may object to a purchaser under Section VI(C) above.

(3) New Blue Chip shall not, during the period of one year following the consummation of the sale: (i) knowingly allow any person operating retail establishments in the contiguous area to issue New Blue Chip stamps to customers of such establishments; or (ii) furnish New Blue Chip stamps to any person with knowledge that the stamps will be issued to customers at any retail establishment in the contiguous area; or (iii) otherwise engage in the trading stamp business in the contiguous area except that, if the purchaser does not elect to redeem New Blue Chip stamps or if the purchaser fails to perform in accordance with his redemption obligations, New Blue Chip shall have the right to redeem its outstanding stamps in said area. Following the said one year period, New Blue Chip shall offer its trading stamp service in the contiguous area.

X.

For the purpose of securing compliance with this Judgment and for no other purpose:

(A) Any duly authorized representative or representatives of the Department of Justice shall, upon written request by the Attorney General or the Assistant Attorney General in charge of the Antitrust Division and on reasonable notice to any defendant, New Blue Chip, or any purchaser under Section IX hereof, made to its principal office, and subject to any legally recognized privilege, be permitted:

(1) Access during the office hours to all books, ledgers, accounts, correspondence, memoranda, and other records and documents in the possession or under

the control of any person specified in this Section X(A) related to any matters contained in this Judgment;

(2) Subject to the reasonable convenience of, and without restraint or interference from, any person specified in this Section X(A), to interview officers or employees of any such person who may have counsel present, regarding any such matters.

(B) Upon written request of the Attorney General or the Assistant Attorney General in charge of the Antitrust Division, any defendant, New Blue Chip or a purchaser under Section IX shall submit such additional reports in writing with respect to the matters contained in this Final Judgment as may be requested. Provided that no information obtained by the means provided for in this Section X shall be divulged by any representative of the Department of Justice to any person other than a duly authorized representative of the Executive Branch of the United States, except in the course of legal proceedings to which the United States is a party for the purpose of securing compliance with this Final Judgment or as otherwise required by law.

XI.

Jurisdiction is retained for the purpose of enabling any of the parties to this Final Judgment to apply to this Court at any time for such further orders and direction as may be necessary or appropriate for construction, carrying out, modification, termination or enforcement of or compliance with the provisions of this Final Judgment and for the punishment of violations thereof.

Dated: June 5, 1967

United States District Judge

[Exhibit "B" to Amended Complaint]

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[Filed October 13, 1967]

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, *Plaintiff,* vs. BLUE CHIP STAMP COMPANY; ALEXANDER'S MARKETS; LUCKY STORES, INC.; MARKET BASKET; PURITY STORES, INC.; RALPHS GROCERY COMPANY; SAFEWAY STORES, INCORPORATED; THRIFTIMART, INC.; THRIFTY DRUG STORES CO., INC.; and VON'S GROCERY CO., *Defendants.*	CIVIL ACTION NO. 63-1552-F REVISED ORDER APPROVING PLAN OF REORGANIZATION WITH CERTAIN CONDITIONS

The defendants having lodged with the Court on August 3, 1967 a Plan of Reorganization (copy of which is attached hereto as Exhibit A) pursuant to Paragraph V of the Final Judgment entered herein on June 5, 1967, and the matter having come before the Court on defendants' motion for approval of the said Plan of Reorganization, which said motion was noticed for hearing on August 21, 1967 and thereafter continued to August 29, 1967, and notice of said hearing and of the continuance thereof having been given to the parties hereto and to the attorneys for the various persons who have appeared in this matter as amicus curiae or otherwise, and the Court, having heard the arguments and

considered the same, and having determined that the said Plan of Reorganization is substantially in accordance with "Reorganization Plan 'B' For Blue Chip Stamp Company" lodged with this Court on April 28, 1967 and filed June 5, 1967, now Orders as follows:

1. The Court finds that the said Plan of Reorganization of Blue Chip Stamp Company is substantially in accordance with Reorganization Plan "B" for Blue Chip Stamp Company lodged on April 28, 1967 and filed June 5, 1967.

2. The Court approves the said Plan of Reorganization subject to the following conditions:

(a) Except to the extent that restraints are imposed on the retailer defendants by the Final Judgment or the Plan of Reorganization with respect to the purchase of additional shares by any of them, or are imposed by the purchase agreements with management employees or by the Securities Act of 1933 on shares to be subject to a qualified stock option plan, there shall be no restraint upon free alienation of any of the shares to be issued.

To enable the retailer defendants and the other present stockholders of Blue Chip Stamp Company to sell any or all of their shares in compliance with the Securities Act of 1933, New Company shall register under that Act the shares of such stockholders at such time or times as may be requested by any of them, but in no event shall New Company be obligated to so register more than one time in any calendar year. New Company shall not be obligated to pay any of the expenses of such registrations nor to keep any registration referred to in this subsection (a) effective for longer than six months; provided, however, that New Company shall be obligated to pay expenses (other than underwriting fees) for one registration if the

request for the same shall have been made during the three months period commencing January 1, 1969 and for one additional registration if the request for the same shall have been made during the three months period commencing January 1, 1970. Within ten days of receipt of any written request from such a stockholder to register its shares, New Company shall give notice thereof to all other of said stockholders and offer them an opportunity to join in the registration so requested. The Company shall file such Registration Statement with the Securities and Exchange Commission on or before May 31 of that year.

With the exception of the two registrations which may be requested in the two three-month periods referred to above, all expenses, direct and indirect, of registrations, if any, requested by such a stockholder or stockholders shall be paid for by it or them, and within ten days of receipt of such a written request from such a stockholder to register its shares, New Company shall give notice thereof to all other such stockholders and offer them an opportunity to join in and share the expense of the registration so requested.

If at any time prior to June 5, 1977, as a result of purchases by New Company of its shares, the aggregate of shares beneficially owned by the retailer defendants exceeds 43% of (a) the Company's outstanding shares and (b) the Company's shares reserved for issuance pursuant to a qualified stock option plan, the Company shall present to the Court within 60 days a plan for disposing of a number of shares sufficient to reduce the percentage of shares beneficially owned by the retailer defendants below such 43%.

(b) Within 60 days after the election of the Permanent Directors of the New Company, the New Company shall present to the Court a plan for the disposition of all unsubscribed shares.

(c) Approval of the Plan of Reorganization does not constitute a finding or any expression of opinion with respect to California law, or as to whether the provisions of said Plan with respect to indemnification are or will be valid or enforceable.

DATED: October 13, 1967.

/s/ WARREN J. FERGUSON
United States District Judge

APPROVED AS TO FORM:

STANLEY E. DISNEY
LAWRENCE W. SOMERVILLE

By /s/ STANLEY E. DISNEY
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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, *Plaintiff,* vs. BLUE CHIP STAMP COMPANY; ALEXANDER'S MARKETS; LUCKY STORES, INC.; MARKET BASKET; PURITY STORES, INC.; RALPHS GROCERY COMPANY; SAFEWAY STORES, INCORPORATED; THRIFTIMART, INC.; THRIFTY DRUG STORES CO., INC.; and VON'S GROCERY CO., *Defendants.*	CIVIL ACTION NO. 63-1552-F PLAN OF REORGANIZATION OF BLUE CHIP STAMP COMPANY SUBMITTED PURSUANT TO SECTION V OF FINAL JUDGMENT ENTERED JUNE 5, 1967

I.
GENERAL STATEMENT OF PLAN OF REORGANIZATION

Pursuant to the decree entered by the United States District Court (the "Court") on June 5, 1967 (the "Decree"), Blue Chip Stamp Company, a California corporation ("Blue Chip"), has developed the plan of reorganization hereinafter set forth (herein the "Plan").

The Plan contemplates the formation of a new California corporation (herein "New Company") with an authorized capitalization of 1,400,000 shares of Common Stock, par value 33⅓ cents per share, the issuance of a single share of its stock for cash to Blue Chip, the merger of Blue Chip into it with the result that each holder of Blue Chip stock shall receive 1,200 shares of the Common

Stock of New Company for each Blue Chip share held (of whichever class). This will result in there being outstanding (assuming no Blue Chip shareholders dissent) 621,600 shares of New Company, all owned by the present shareholders of Blue Chip. Prior to the merger the stockholders of Blue Chip will make a capital contribution in the aggregate amount of $155,400 in cash to Blue Chip. An offering of approximately 621,600 shares of its Common Stock will then be made by New Company to users of Blue Chip stamps (who issue stamps to their retail customers as a reward for patronage) other than users who are also shareholders of Blue Chip (such users to whom such offering is to be made are hereinafter referred to as "Users") on a prorata basis determined by the quantity of stamp pads issued to Users during the period subsequent to March 1, 1964 and prior to a date to be determined which will be not more than 90 days prior to the effective date of the registration statement hereinafter referred to. The offering will be made in units consisting of three shares of the Common Stock of New Company and one $100 principal amount debenture for a cash consideration of $101. New Company will also adopt a qualified stock option plan and will grant options pursuant thereto to key employees covering an aggregate of 110,400 shares of its Common Stock. New Company will also offer to sell 27,600 shares to key executive employees at a price of 33⅓ cents per share. The steps taken pursuant to the Plan will be substantially in accordance with those set forth in Sections II and III below.

II.

VARIOUS STEPS OF THE PLAN

A. Formation of New Company.

A California corporation will be formed with an authorized capitalization of 1,400,000 shares of Common Stock of the par value of 33⅓ cents per share. The articles of

incorporation will provide for three incorporators who will be the first directors.

After the filing of the articles of incorporation with the Secretary of State of the State of California, the incorporators will hold an organization meeting adopting by-laws, stock certificates, seal, providing for a principal office and various other ministerial matters. In addition the first directors will authorize the filing of an application for permit with the Commissioner of Corporations of the State of California (the "Commissioner") to permit the sale and issuance of one share of its stock to Blue Chip and the sale of such share in accordance therewith. Temporary officers will be elected.

The application for permit will be filed with the Commissioner and a permit obtained as promptly as possible thereafter. A share will then be sold to Blue Chip for $1. Blue Chip, as the sole shareholder of New Company, will then amend the by-laws to provide for a board of 11 directors. Immediately thereafter the first directors will tender their resignations and elect 11 temporary directors, all of whom will be the present directors of Blue Chip. The first directors will also elect as officers of New Company the present officers of Blue Chip, each holding the respective office that he holds in Blue Chip. Following the close of the subscription offering to Users, there shall be a meeting of the shareholders of New Company for the purpose of electing a new board of directors (the "Permanent Directors").

B. Merger of Blue Chip into New Company.

After the first share of New Company is issued, Blue Chip and New Company will enter into an agreement of merger which will provide for the issuance, upon the merger, of 1,200 shares of the Common Stock of New Company for each share of Blue Chip of either class then outstanding. New Company will, expressly, and by opera-

tion of law under the California statutes governing statutory mergers, acquire all the assets of Blue Chip. In consideration for such transfer of assets, New Company will assume all liabilities of Blue Chip arising out of its organization and operations prior to the date the Decree becomes final and not subject to appeal, including, without limitation, those existing by virtue of antitrust claims against Blue Chip, its past and present officers, directors and shareholders, by virtue of Blue Chip's organization and operations and liabilities of Blue Chip, its officers, directors and shareholders arising from carrying out this plan of reorganization. A special shareholders' meeting of Blue Chip will be called and noticed, which notice shall be accompanied by a statement of the terms of the proposed merger and also of the contemplated offering to management personnel and to Users. The special meeting of Blue Chip shareholders will be held approving the merger and, concurrently with this meeting Blue Chip, as the sole shareholder of New Company, will approve the merger by written consent. Notice will then be mailed to all shareholders of both corporations of the approval of the merger, thus starting the statutory period within which a dissenter may give notice of his dissent.

Immediately prior to the effectiveness of the registration statement concerning the offering to Users, the merger agreement will be filed with the Secretary of State of the State of California, thus effecting the merger. Each of such defendants shall, prior to the shareholder meeting for the election of Permanent Directors, deliver its shares to a separate and independent trustee acceptable to the Department of Justice or the Court. Such defendants may sell any of their shares at any time, but are prohibited from purchasing any additional shares for a period of ten years.

C. Offering to Users.

1. California Commissioner of Corporations

New Company will file an application with the Commissioner of Corporations of the State of California for a permit authorizing it to sell, in accordance with the terms of offering set forth below, to the Users units consisting of three shares of its Common Stock combined with one $100 principal amount debenture for a cash price of $101.

2. Securities and Exchange Commission.

New Company will prepare and file a registration statement on Form S-1 under the Securities Act of 1933 with the Securities and Exchange Commission (the "SEC") covering the offering to Users. It is contemplated that there will be a prefiling conference with the SEC and a request for expeditious examination of the registration statement and the issuance of a letter of comments thereon. As soon as practicable after the comments are received, an appropriate amendment or amendments to the registration statement will be filed in response thereto. The registration statement relating to the offering will be declared effective and the indenture, pursuant to which the debentures will be issued, will be qualified under the Trust Indenture Act of 1939.

3. The Units.

Each unit shall consist of three shares of the Common Stock of New Company and one $100 principal amount debenture. The debentures shall mature ten years after their date, shall bear interest, payable quarterly, at 6% or at one-half per cent above the prime rate in effect in Los Angeles on the date the registration statement is initially filed with the Securities and Exchange Commission, whichever is higher, shall be subordinated to claims or causes of action, including, without limitation, claims under the antitrust laws, against Blue Chip and

its past and present officers, directors and stockholders relating to Blue Chip operations prior to the date the Decree becomes final and not subject to appeal, or arising from the reorganization covered by this Plan, may be paid (in whole or in part) without penalty at any time after six years after their date, and will be entitled, after provisions for subordination, to mandatory sinking fund payments equal to 20% of the aggregate principal amount outstanding on the sixth anniversary of their date of issuance on such date and on the seventh, eighth and ninth such anniversary dates. The debentures will be issued pursuant to an indenture which will be qualified under the Trust Indenture Act of 1939 and will contain other usual provisions.

4. Offer to Users.

As soon as the registration statement has been declared effective by the SEC: each past User whose name appears on Blue Chip Records as a "house account" during the period subsequent to March 1, 1964 and prior to a date to be determined which will be not more than 90 days prior to the effective date of the registration statement referred to above, and each current user, will have mailed to its latest address according to the records of Blue Chip a copy of the prospectus, together with a notice that such Users will be offered the opportunity to purchase units after their respective entitlements have been ascertained.

Advertisements will also be placed in appropriate newspapers advertising that an offering of units will be made to the Users of stamps subsequent to March 1, 1964 and advising that any of such Users who have not been sent the mailing by the Company referred to above may request a copy of the prospectus and a form on which such User may establish his usage since March 1, 1964 for the purpose of participating in the offering. Thirty days

after the publication of the first such advertisement, the right of Users to establish their usage shall terminate.

Immediately thereafter New Company shall commence the preparation of a list of all Users who have been sent the mailing referred to above and those who have responded to the advertisement and have established their eligibility as Users. Such list shall show, with respect to each User, the number of units to which such User is entitled, determined as set forth below. As soon as practical thereafter there shall be mailed to all such Users a subscription form on which will be stated the maximum number of units that the respective User is entitled to purchase. The subscription form shall state that the User may purchase any lesser number of units. Such subscription rights shall not be transferable and the securities constituting the Units purchased will be issued only in the name of the User.

For a period of 30 days after all subscription forms are mailed out, each User may complete the form agreeing to buy the number of units (up to the stated maximum) which he sets forth thereon and send the form, together with a check covering the purchase price of such units, to the Subscription Agent, which shall be a bank located in Los Angeles, California. Such subscription offer shall terminate at the close of business on the thirtieth day after the mailing of the subscription form. New Company shall instruct the Subscription Agent to issue securities comprising the units purchased and send them to the purchasers thereof, all in accordance with the terms of the offer, provided that no units shall be issued until the check representing the purchase price has cleared.

5. Method of Determining User's Entitlement to Units.

The number of units which each User shall be entitled to purchase shall be determined as follows: 207,200 units (the total number of units to be offered) will be available

to all nonstockholder users during the period between March 1, 1964 and a date to be determined which will be not more than 90 days prior to the effective date of the registration statement referred to above. Each eligible User will be entitled to units as its total use during such period bears to the total use by all nonstockholder users during such period, with a minimum of one unit. No fractional units shall be issued. The number of units to which any User is entitled shall be rounded to the nearest whole unit (with all Users being entitled to a minimum of one Unit), and those entitled to an even one-half unit shall be rounded to the next higher full unit.

D. Offering to Management and Qualified Stock Option Plan.

1. California Commissioner of Corporations.

New Company will file an application with the Commissioner of Corporations of the State of California for a permit authorizing it to sell 27,600 shares of its Common Stock to management employees at a price of 33⅓ cents per share. It will concurrently apply for the permit of the Commissioner authorizing the grant of options pursuant to the qualified stock option plan and the issuance of shares pursuant thereto.

2. Terms of Offering to Management.

The shares to management employees will be sold immediately after the merger under a separate purchase agreement with each employee which will provide, among other things, that the shares subject thereto cannot be sold, transferred or hypothecated by the purchaser for a specified period of time and that during such period of time if such employee voluntarily (as defined in the agreement) terminates his employment with New Company or attempts to sell his stock in violation of the agreement, New Company shall have the right to buy such shares at

the price which he paid for them. Such restrictions and the resale obligation will terminate with respect to 20% of each management employee's shares in each of five consecutive years, with all such restrictions and obligations being terminated not later than January 1, 1974.

3. Terms of the Qualified Stock Option Plan.

The qualified stock option plan will be adopted by the directors of New Company and approved by its shareholders immediately following the merger. The qualified stock option plan will cover 110,400 shares of New Company Common Stock, will provide for the grant of options thereon at not less than the fair market value of the shares on the date of grant, the options granted will be exercisable in installments of 25% thereof at the end of each of the first, second, third and fourth years after the date of grant, the person acquiring the shares on exercise of the option will give an investment letter with respect thereto (unless the stock is registered under the Securities Act of 1933), and the options shall not be transferable, except to a limited extent upon the death of an optionee. The options will terminate not more than five years after the date of grant. It is contemplated that the option plan will contain provisions which are standard in such plans.

E. Compliance with Decree by New Company.

Blue Chip and New Company (as Blue Chip's successor under Section III of the Decree) will conduct the operations of the trading stamp business in accordance with the provisions of Section VIII(A) of the Decree. New Company will be regarded as "New Blue Chip" under the Decree upon the election of the Permanent Directors of New Company. The Permanent Directors will authorize and cause New Blue Chip to enter its appearance in *United States v. Blue Chip Stamp Company, et al.* and to give the required consent pursuant to the provisions of Section

VIII(B) of the Decree. At that point New Blue Chip will become bound by the provisions of Section VIII(B) of the Decree; New Blue Chip will engage in the trading stamp business for a reasonable period of time thereafter; and New Blue Chip and the stockholder defendants will thereafter be precluded from having common officers, directors and employees. (See Sections VIII(B) and (C) of the Decree.) As is indicated above, prior to the shareholder meeting for the election of Permanent Directors the stockholder defendants will have placed their stock in trust so that the voting rights of the shares of each of the stockholder defendants may be exercised only by persons acceptable to the Department of Justice or to the Court.

F. Disposition of Unsubscribed Shares, If Any.

Based upon the outcome of the offering to Users and employees, the Permanent Directors will take such steps as may be necessary to complete the reorganization by obtaining an appropriate disposition of any unsubscribed shares.

III.

PRINCIPAL ACTIONS

The following sets forth a summary of specific steps contemplated for effecting the Plan. New Company will try to complete the action necessary in connection with carrying out the Plan as expeditiously as is reasonably practicable. Certain events are dependent upon action by other persons or entities and the speed with which such action will be taken will not always be within the control of New Company.

1. Incorporate New Company.

2. File application with Commissioner of Corporations of the State of California (the "Commissioner")

for a permit authorizing the issuance of one share of New Company to Blue Chip.

3. File application with the Commissioner for a negotiating permit authorizing the signing of the merger agreement.

4. Obtain permit.

5. Boards of directors of Blue Chip and New Company approve merger.

6. Send notice of special meeting of stockholders and proxy statement to shareholders of Blue Chip.

7. File application with the Commissioner for a definitive permit authorizing the merger and the issuance of shares.

8. File registration statement with the SEC under the Securities Act of 1933 to register the units to be offered to Users.

9. File application with the Commissioner for a permit authorizing the offering to Users, and sale of shares to management employees and the grant of options under the qualified stock option plan and the sale of shares pursuant thereto.

10. Hold special meeting of stockholders of Blue Chip to approve merger; stockholder of New Company consents to merger.

11. Send notice to shareholders of Blue Chip advising as to approval of merger.

12. Take any other necessary action with respect to blue sky or securities laws of any other states in which the offering will be made.

13. Receive comments on the registration statement from the SEC.

14. File the first amendment to the registration statement with the SEC.

15. File a second amendment to the registration statement, if necessary, with the SEC.

16. Obtain permit authorizing the merger and the offering of units, shares and options from the Commissioner.

17. File agreement of merger with the Secretary of State of the State of California effecting merger.

18. Hold meeting of New Company stockholders to adopt qualified stock option plan.

19. Registration statement declared effective.

20. Sell shares to management employees.

21. Mail copy of prospectus to all known Users, together with advice that offering will be forthcoming.

22. Make a public solicitation for information concerning other Users who would be entitled to participate in the offering.

23. Right of Users to prove their entitlement to units or to indicate their interest in participating terminates.

24. Send subscription forms to Users entitled to participate in the offering advising as to the number of units to which the User is entitled.

25. Subscription period ends.

26. Complete issue of units to those purchasing them.

27. Select trustees to hold shares and obtain necessary approval thereof.

28. Hold meeting of shareholders to elect Permanent Directors.

29. Authorize and enter appearance of New Blue Chip.

[Letterhead of O'Melveny & Myers omitted in printing.]

July 31st, 1967

Stanley E. Disney, Esq.
Chief, Los Angeles Office
Department of Justice,
Antitrust Division
836 United States Court House
312 North Spring Street
Los Angeles, California 90012

Re *United States v. Blue Chip Stamp Company, et al.*

Dear Mr. Disney:

This letter is written pursuant to your request in order to explain the background of certain aspects of the proposed plan of reorganization.

Under the reorganization provisions of the decree, it was contemplated that an interest in the Blue Chip business would be offered to numerous third parties and that once participation of the new owners was established, the new ownership would exercise control over the affairs of the business. Plan "A" provided for the transfer of ownership in a reorganization, conducted within Blue Chip's present corporate framework, by an offering of the stock of the existing company. Plan "B" reached the same result by an offering of the stock of a new company which Blue Chip would create and into which it would be merged.

If Plan "A" of the decree were being followed, the present directors of Blue Chip would automatically remain until the completion of the offering to users, at which time the new ownership would elect its new board of directors. Under Plan "B", the plan which Blue Chip has elected to follow, the technical steps necessary to carry out the Plan call for the creation of a new company prior to the time at which the offering can be made, and thus the directors of Blue Chip will serve as the directors of the new company until after the offering when the new owners can elect their own directors. This produces the same result as would obtain under Plan "A".

We also wish to point out that it is also necessary for the directors to continue in office until the offering to users, because of certain practical problems. Under the Securities Act of 1933, each director is responsible, in his individual capacity, for all of the material contained in the SEC registration statement covering the offering of stock to users. If, at the time the prospectus is being used, it is known that any other persons will be directors, such fact would have to be disclosed in the prospectus, such persons would have to give their consent to being named, and the execution of such consent would subject them to the same liabilities under the Securities Act of 1933 as though they signed the registration statement as directors. These liabilities would attach even though such persons had no present affiliation with the company. Under these circumstances, it is the opinion of the management of Blue Chip Stamp Company, that it would not be possible nor would it be practical to obtain new independent directors of the caliber desired for the company for the short period of time between the creation of the new corporate shell and the offering to users — such short term service carrying with it the necessary condition of possible extensive personal liability.

You also requested that we estimate the amount of time involved in carrying out the plan of reorganization. We estimate that by November 30, 1967 it will be possible to have the registration statement declared effective by the Securities and Exchange Commission. By this time all of the other steps which are necessary to begin the actual making of the offering to users should have been accomplished. The mechanics of the offering should embrace an additional two to three months. Once the subscriptions are closed the shareholders' meeting to elect the new board of directors can be accomplished promptly. These estimates are based on the assumption, of course, that regulatory approvals or court proceedings will not unduly prolong the schedule.

Very truly yours,

WILLIAM W. ALSUP
of O'Melveny & Myers

BLUE CHIP STAMPS

$20,720,000 6½% Subordinated Debentures due 1978

621,600 Shares of Common Stock, Par Value $.33⅓ per Share

THESE SECURITIES ARE OFFERED AS A SPECULATION. ATTENTION IS DIRECTED TO "ITEMS OF SPECIAL INTEREST" ON THE FOLLOWING PAGE. PRIOR TO THIS OFFERING THERE HAS BEEN NO MARKET FOR THE COMMON STOCK OR THE DEBENTURES.

Offered Only in Units, each Unit (hereinafter a "Unit") Consisting of $100 Principal Amount of the 6½% Subordinated Debentures due 1978 of Blue Chip Stamps (the "Company") and Three Shares of Common Stock of the Company for a Price of $101 per Unit (See "Offer to Users" herein).

The 6½% Subordinated Debentures due 1978 (the "Debentures"), subject to conditions referred to below, are entitled to the benefits of a sinking fund, commencing in 1974, in an annual amount which could total 20% of the aggregate principal amount of Debentures outstanding on December 1, 1974 and which could retire as much as 80% of the Debentures prior to maturity. The Company may not make a sinking fund payment if Claims or Causes of Action after such payment would exceed 50% of stockholders' equity. Claims or Causes of Action include a) the amount of claims asserted in lawsuits against the Company or Blue Chip Stamp Company or officers, directors or stockholders of the Company or Blue Chip Stamp Company based upon Blue Chip Stamp Company's organization or operations or the acts of such officers, directors or stockholders in connection therewith, including those based on alleged violations of antitrust laws or arising out of the Plan of Reorganization (described in "Plan of Reorganization" herein), and b) claims asserted by such officers, directors or stockholders based upon indemnifications by the Company and Blue Chip Stamp Company holding them harmless from liability arising out of the claims asserted in a) above. Claims or Causes of Action now aggregate approximately $29,000,000. The Debentures are subordinated to payments of Senior Indebtedness, which term includes certain indebtedness of the Company to banks and other lending institutions and the amounts owing by the Company on Claims or Causes of Action established by court judgments or otherwise settled and agreed to by the Company, and prior to December 1, 1978 the Debentures are also subordinated to all Claims and Causes of Action as above defined. See "Description of Debentures" for definitions and other relevant descriptions. Interest will be payable on March 1, June 1, September 1, and December 1.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public(1)	Underwriting Discounts and Commissions	Proceeds to Company(1)(2)
Per Unit	$101	None	$101
Total	$20,927,200	None	$20,927,200

(1) Before deducting expenses estimated at $49,200 payable by the Company.
(2) Based upon the assumption that all Units offered are sold.

The Company is offering to certain Users of its stamps the right to purchase Units based upon their usage of stamps during the period between March 1, 1964 and June 1, 1968. See "Offer to Users" herein. The Company is concurrently offering certain of its employees the right to purchase an aggregate of 27,600 shares of its Common Stock, par value $.33⅓ per share, for a price of $.33⅓ per share. See "Offer to Employees" herein. The rights of Users to purchase Units will expire as set forth under "Offer to Users" herein.

This offering is not underwritten, and the Company has no assurance that all of the securities offered hereby will be sold.

The date of this prospectus is August 29, 1968, as supplemented.

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ITEMS OF SPECIAL INTEREST

Prospective purchasers of securities offered herein should particularly note the following items, each of which will be or may be adverse and which is discussed later in this prospectus in greater detail:

(1) Net income for the current fiscal year will be adversely affected by payments aggregating $8,486,000 made since March 2, 1968 in settlement of claims against the Company (see "Statement of Income and Retained Earnings" and "Litigation").

(2) Net income would be adversely affected by a substantial decrease in the use of the Company's trading stamp service (see "Business — General").

(3) Net income would be adversely affected by a sale of one-third of the Company's trading stamp business in California; approximately 99% of the Company's stamp service income is derived from its operations in California (see "Business — Effects of Consent Decree on Company's Operations").

(4) Claims or Causes of Action (as defined) against the Company, including prayers for treble damages, now aggregate approximately $29,000,000. The Company has agreed to indemnify Blue Chip Stamp Company and the present and former officers, directors and stockholders of the Company or Blue Chip Stamp Company from any liability or expense arising out of certain claims asserted against any of them (see "Litigation").

(5) All but two of the present directors are precluded until June 5, 1977 from serving as directors after the first meeting of the Company's stockholders following the offering herein so long as they are employed by specified companies (see "Management").

INDEX

	Page
The Company	3
Plan of Reorganization	3
Offer to Users	5
Offer to Employees	6
Use of Proceeds	7
Capitalization	7
Dividends	7
Statement of Income and Retained Earnings	8
Business	10
Property	15
Management	16
Litigation	18
Interest of Management in Certain Transactions	26
Description of Debentures	26
Description of Common Stock	30
Legal Opinions	30
Experts	30
Opinion of Independent Accountants	31
Financial Statements	32

THE COMPANY

Blue Chip Stamps (herein called the "Company") was incorporated under the laws of the State of California on February 5, 1968. On July 16, 1968 it succeeded by merger to the business of Blue Chip Stamp Company, which had been formed on May 14, 1956. References to the "Company" in this prospectus are to Blue Chip Stamps and to its predecessor, unless the context otherwise provides. The Company, whose principal offices are located at 5801 South Eastern Avenue, Los Angeles, California, is and has been since 1956 engaged primarily in furnishing a trading stamp service to retail merchants and their customers. At March 2, 1968 approximately 20,000 retailers licensed by the Company to use its trading stamp services were distributing Blue Chip stamps in over 23,000 retail outlets in California and Nevada. The Company maintains 84 redemption stores where savers of Blue Chip stamps may redeem them for a wide variety of merchandise or for cash. The Company is also engaged in the development of incentive programs and premium promotions, primarily for industrial, commercial and other companies, which now represents a small but growing part of the Company's business.

The Company's predecessor was organized by a group of retail grocery chains with the approval and support of a large segment of the grocery industry and other retail merchants in California. In December 1963 the United States Department of Justice filed an action under the Sherman Act against Blue Chip Stamp Company and nine of its twelve stockholders (see "Litigation" herein for a more detailed description of that litigation). On June 5, 1967 a Consent Final Judgment (the "Consent Decree") was entered in the United States District Court, Central District of California (Civil Action No. 63-1552-F) providing for the reorganization of Blue Chip Stamp Company under a plan which has been approved by the Court ("the Plan of Reorganization").

PLAN OF REORGANIZATION

The Plan of Reorganization provides for the formation of the Company as a wholly-owned subsidiary of Blue Chip Stamp Company, and the merger of Blue Chip Stamp Company into it. Such merger has been completed and 621,600 shares of the Company's Common Stock issued in the merger are now outstanding.

Under the terms of the merger, the Company has indemnified Blue Chip Stamp Company and all present and former stockholders, directors and officers of the Company or of Blue Chip Stamp Company from any liability or expense arising out of certain claims asserted against any of them. The Plan of Reorganization provides for an offering by the Company, as Units, of approximately an additional 621,600 shares of its Common Stock, together with approximately $20,720,000 in principal amount of its 6½% Subordinated Debentures due 1978, to be made to users of Blue Chip stamps (who issue stamps to their retail customers as a reward for their patronage) on a pro rata basis to be determined by the quantity of the stamp pads issued to Users during the period between March 1, 1964 and June 1, 1968. See "Offer to Users" herein. Present stockholders of the Company and incentive program clients of the Company are not "Users" and are not entitled to participate in the offering of these Units. (The

users to whom such offering is to be made pursuant to the Plan of Reorganization are hereinafter referred to as "Users"). The Plan of Reorganization also requires the Company to offer to sell 27,600 shares of its Common Stock to certain employees at a price of $.33⅓ per share and to adopt a qualified stock option plan and grant options pursuant thereto to key employees covering an aggregate of 110,400 shares of its Common Stock.

Blue Chip Stamp Company, pursuant to a policy of its organizers and Board of Directors, paid no dividends at any time. In 1964, Blue Chip Stamp Company paid a patronage rebate to its users of approximately $1,901,000. The Company (Blue Chip Stamps) has been organized with the intention of paying dividends subject to the restriction referred to under "Dividends". It is the intention of the Company to pay no patronage or other rebate to any User.

The Plan of Reorganization also requires that the Company present to the Court a plan for the disposition of all unsubscribed shares within sixty days after the election of a new board of directors as described under "Management." It is presently expected that any such offering will consist of shares of common stock only and will be made by the Company after completion of the offering described in this prospectus at a price at or near the price at which shares of the Company's common stock are then being traded.

The Plan of Reorganization further requires that:

Except to the extent that restraints are imposed on the nine Stockholders referred to above by the Consent Decree or the Plan of Reorganization with respect to the purchase of additional shares by any of them, or are imposed by the purchase agreements with management employees or by the Securities Act of 1933 on shares to be subject to a qualified stock option plan, there shall be no restraint upon free alienation of any of the shares issued by the Company.

To enable the nine Stockholders referred to above and the other three stockholders who were the twelve stockholders (the "twelve stockholders") of the Blue Chip Stamp Company to sell any or all of their shares of the Common Stock of the Company in compliance with the Securities Act of 1933, the Company is required to register under that Act the shares of any of the twelve stockholders at such time or times as may be requested by any of them. The Company is obligated to pay the expenses of one such registration if requested during the three months period commencing January 1, 1969 and one such registration if requested during the three months period commencing January 1, 1970. Otherwise registration expenses are to be paid by stockholders requesting them. Within ten days of receipt of any such written request for registration the Company must give notice thereof to all the other twelve stockholders and offer them an opportunity to join in the registration so requested. The Company shall file registration statements so requested with the Securities and Exchange Commission on or before May 31 of the year of request.

If at any time prior to June 5, 1977, as a result of purchases by the Company of its shares, the aggregate of shares beneficially owned by the nine Stockholders referred to above exceeds 43% of the sum of (a) the Company's outstanding shares and (b) the Company's shares reserved for issuance pursuant to a qualified stock option plan, the Company must present to the Court within 60 days, a plan for disposing of a number of shares sufficient to reduce the percentage of shares beneficially owned by such nine Stockholders below such 43%.

OFFER TO USERS

Past Users of the Company's trading stamps whose names appear on the Company's records as "house accounts" during the period subsequent to March 1, 1964 and prior to June 1, 1968 and each current User, will have mailed or hand delivered to its latest address according to the Company's records a copy of the prospectus, together with a notice that such Users will be offered the opportunity to purchase Units after their respective entitlements have been ascertained. Current Users served by Company salesmen will also be provided with a form on which to establish usage during the period stated above.

Advertisements will also be placed in appropriate newspapers informing Users that an offering of Units will be made to Users of the Company's stamps subsequent to March 1, 1964 and advising that Users who have not received a copy of the prospectus and notice referred to above may request a copy of the prospectus and a form on which such User may establish his usage since March 1, 1964 for the purpose of participating in the offering. Thirty days after the publication of the first such advertisement, the right of Users to establish their usage shall terminate.

Immediately after the close of such period, the Company will calculate the number of Units to which each User is entitled, determined as follows: 207,200 Units (the total number of Units offered), each consisting of three shares of Common Stock and a $100 principal amount of Debenture, will be available to all Users during the period between March 1, 1964 and June 1, 1968. In accordance with the Plan of Reorganization, each eligible User will be entitled to such Units as its total use of stamps during such period bears to the total use by all Users during such period, with each User being entitled to a minimum of one Unit. No fractional Units are to be issued, the number of Units to which any User may be entitled are to be rounded to the nearest whole Unit and those Users entitled to an even one-half Unit shall be rounded to the next higher whole Unit. All entitlements will be determined by the Company, and the Company's determination will be final.

As soon as practicable after the computation of Unit entitlements, the Company will mail to all Users whose usage has been established during the applicable period a subscription form on which will be stated the maximum number of Units that the respective Users are entitled to purchase. Each User is entitled to purchase up to the stated maximum number of Units. The subscription rights are not transferable and the securities constituting the Units purchased will be issued only in the name of the User.

Each User may complete the subscription form agreeing to buy the number of Units (up to the stated maximum) which he sets forth thereon and send the form, together with a check covering the purchase price of such Units, to Bank of America National Trust and Savings Association, the Subscription Agent. Such subscription offer shall terminate at the close of business on the 30th day after the mailing of the subscription form, which termination date will be set forth on the subscription form, and subscriptions must be mailed to the Subscription Agent prior to such termination. The Subscription Agent will issue the securities comprising the Units purchased promptly after the check representing the purchase price has cleared.

A stockholder need not use the Company's trading stamp service nor is it necessary to be a stockholder in order to be eligible to use the Company's trading stamp service.

Tax Effect to Users

If the Units sold to Users pursuant to this offering should, by reason of subsequent market values, be held to have had a greater value at date of sale than the amount paid for them, Users may be subject to ordinary income tax on such difference. Also see "Federal Tax Consequences of Original Issue Discount" under "Description of Debentures" herein for possible tax consequences relating to the Debentures.

OFFER TO EMPLOYEES

Pursuant to the Plan of Reorganization, the Company is offering to certain of its employees the right to purchase an aggregate of 27,600 shares of its Common Stock at a price of $.33⅓ per share. Any such shares purchased will be pursuant to an agreement in which the purchaser agrees not to sell, transfer or hypothecate the shares for specified periods of time and that he will offer to resell them to the Company if his employment with the Company should be terminated for reasons specified in the agreement or if he attempts to transfer shares in contravention of the agreement. Such restrictions and the resale obligation will terminate with respect to 20% of each employee's shares in each of five consecutive years, with all such restrictions and obligations being terminated not later than January 1, 1974. All restrictions will terminate on the employee's death with respect to shares held by him. The certificates representing shares will be held in escrow by the Company and released to the purchaser at such time as the restrictions and other obligations with respect thereto terminate.

The Company has received a ruling from the Internal Revenue Service with respect to the purchase of shares by management employees to the effect that:

1. No taxable income will be realized by the employee at the time of purchase.

2. The employee will realize taxable compensation income, if any, at such time as the restrictions on the shares lapse, in an amount equal to the lesser of:

   (i) The difference between the purchase price and the fair market value of the shares without restrictions at the time of purchase by the employee, or

   (ii) The difference between the purchase price and the fair market value of the shares at the time of lapse of the restrictions.

3. The employee's basis for the shares will be their purchase price plus the compensation income, if any, with respect to such shares realized by him.

4. The Company will be entitled to a deduction for compensation paid at the same time and in the same amount as compensation income, if any, is realized by employees.

USE OF PROCEEDS

The net proceeds to be received by the Company from the sale of the Units and the shares being offered to management employees, which will approximate $20,884,700 if all are sold, will be used, with other assets of the Company, for the purposes of:

a. Paying such amounts, if any, as may be owed by the Company on Claims or Causes of Action (see "Litigation" and "Description of Debentures" — "Claims or Causes of Action" herein) established by court judgments or otherwise settled and agreed to by the Company; and

b. Diversifying its activities through acquisitions or otherwise (at present the Company is not engaged in negotiations looking toward any acquisition); and

c. For general corporate purposes.

CAPITALIZATION

The table below sets forth the capitalization of the Company as of July 1, 1968 and as adjusted to reflect consummation of the merger described under "The Company" herein and to give effect to the sale of the Debentures and Common Stock, including the sale of shares to employees (assuming all such securities are sold).

	As of July 1, 1968		
Title of Class	Amount Authorized	Amount Outstanding	As Adjusted
6½% Subordinated Debentures due 1978	$20,720,000	-0-	$20,720,000
Common Stock, par value $.33⅓	1,400,000 shs	621,600 shs	1,270,800 shs (1)

(1) Not including 110,400 shares reserved for issuance pursuant to the Company's Qualified Stock Option Plan (see "Management" herein).

DIVIDENDS

The Company has not heretofore paid cash or other dividends on its stock, and, in view of the Indenture restrictions on payment of dividends referred to in "Description of Debentures" — "Dividend Restrictions" herein, does not presently plan to do so. The Company expects to pay cash dividends in the future, but neither the times at which such dividends may be paid nor the amounts thereof have been determined. Such determinations will be made by the Board of Directors then in office (see "Management") in the light of future earnings, the financial needs and condition of the Company and other relevant factors.

BLUE CHIP STAMPS

STATEMENT OF INCOME AND RETAINED EARNINGS

The following statement has been examined by Price Waterhouse & Co., independent accountants, whose opinion thereon, which is subject to the possible material adverse effect on the Company's financial position of the litigation referred to in Note 8 to the financial statements, appears elsewhere in this prospectus. The statement should be read in conjunction with the other financial statements and notes thereto included elsewhere in this prospectus.

(In Thousands of Dollars)

	Year ended June 30		Eight months ended Mar. 2	Fifty-two weeks ended			Fifty-three weeks ended Mar. 4	Fifty-two weeks ended Mar. 2
	1961	1962	1963	Feb. 29 1964	Feb. 27 1965	Feb. 26 1966	1967	1968
Stamp service income (Note A)	$48,450	$57,038	$43,714	$68,706	$72,305	$81,594	$92,028	$91,757
Income from marketable securities:								
Dividends	71	130	103	262	299	317	458	523
Interest	330	548	535	1,013	1,191	1,410	1,671	1,715
Gains (losses) on sale of securities	7	66	14	129	304	31	(84)	90
Other income	209	282	248	380	461	449	603	579
	49,067	58,064	44,614	70,490	74,560	83,801	94,676	94,664
Costs and expenses:								
Cost of redemptions, consisting of merchandise and related expenses	40,088	48,047	35,065	59,480	65,070	71,470	81,854	83,797
Stamp pads and saver books	1,825	2,105	1,560	2,507	2,320	2,010	2,041	1,942
Advertising and other selling expenses	1,875	2,233	1,174	2,176	2,170	1,829	2,091	2,221
General and administrative expenses	874	1,297	1,097	1,538	1,338	1,217	1,899	1,938
Interest on income tax settlements	391	12	23					
Patronage rebate (Note B)				1,901				
	45,053	53,694	38,919	67,602	70,898	76,526	87,885	89,898
Income before federal income taxes	4,014	4,370	5,695	2,888	3,662	7,275	6,791	4,766
Provision for federal income taxes (Notes A and C)	2,171	2,006	2,891	1,073	1,158	2,809	2,507	1,348†
Net income (Note D)	1,843	2,364	2,804	1,815	2,504	4,466	4,284	3,418
Retained earnings (deficit) at beginning of period	(645)	1,198	3,562	6,366	8,181	10,685	15,151	19,435
Retained earnings at end of period	$ 1,198	$ 3,562	$ 6,366	$ 8,181	$10,685	$15,151	$19,435	$22,853
Net income per average common share (Note E):								
Historical	$2.96	$3.80	$4.51	$2.92	$4.03	$7.18	$6.89	$5.50
Pro forma, assuming that the shares offered herein are fully subscribed and that income from the proceeds of this offering will be equal to the interest expense on the Debentures								$2.69

(A) See Note 2 of Notes to Financial Statements.

(B) See "Litigation" herein.

(C) The entire investment credit (not material in amount) has been taken into income of the respective years as a reduction of the provision for federal income taxes.

(D) See "Business" — "Effects of Consent Decree on Company's Operations" herein.

(E) Neither the historical nor pro forma net income per average common share is necessarily indicative of the future net income per share in view of:

(1) the indeterminate number of shares which may be purchased by Users.

(2) the effect of a possible substantial decrease in the use of the Company's trading stamp service.

(3) the uncertainty as to the ultimate effect of a sale of one-third of the Company's trading stamp business.

(4) claims and causes of action pending against the Company now aggregating approximately $29,000,000.

(5) all but two of the present directors of the Company are precluded until June 5, 1977 from serving as directors after the first meeting of the Company's stockholders following the offering herein so long as they are employed by specified companies.

See "Items of Special Interest" herein and the other parts of this prospectus therein referred to.

(F) See "Dividends" and "Description of Debentures" — "Dividend Restrictions" herein.

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† The provision for federal income taxes does not contain any amount on account of the 10% federal income tax surcharge enacted June 28, 1968. The amount of such surcharge applicable to the period ended March 2, 1968 is approximately $28,000; such amount is included in the figures set forth below for the twenty-two weeks ended August 3, 1968.

The maximum annual requirement for interest on the Debentures (assuming all Units are sold) would be $1,346,800. The amount of "original issue discount," if any, applicable to the Debentures will be amortized over the life of the Debentures.

The decline in net income for the fiscal year ended February 29, 1964 was due primarily to reductions in the amounts charged to licensees for the Company's trading stamp service and to the patronage rebate made to stamp users. See "Litigation" herein. The decline in net income for the fiscal year ended March 2, 1968 was due primarily to the additional costs resulting from operations, commenced in September 1966, of a distribution center in Rancho Cordova; the Company did not renew the lease at Rancho Cordova, which expired June 30, 1968.

The following unaudited summary sets forth stamp service income, income before extraordinary item, extraordinary item, net income and net income per share for the periods indicated. In the opinion of the Company, all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of operations have been made.

	Twenty-two Weeks Ended	
	August 5, 1967	August 3, 1968
Stamp service income	$37,236,000	$44,242,000
Income before extraordinary item	1,310,000	2,637,000
Extraordinary item — Settlements (aggregating $7,928,000) of claims (see "Litigation" and Note 8 of Notes to Financial Statements) less $3,974,000 applicable income taxes*		(3,954,000)
Net income (loss)	1,310,000	(1,317,000)
Net income (loss) per share (historical)	$ 2.11	$ (2.12)

*The figures do not include settlements aggregating $558,000 (less $295,000 applicable income taxes) made October 21, 1968 (see page 24 of prospectus).

BUSINESS

General

The Company is primarily engaged in furnishing a trading stamp service to retail merchants and their customers in California and Nevada. At March 2, 1968, approximately 20,000 retailers were licensed by the Company to use its trading stamp service and were distributing Blue Chip stamps in approximately 23,000 retail outlets. During the fiscal year ended March 2, 1968, fourteen licensees accounted for approximately 38% of the Company's stamp service income. One of these 14 licensees, Safeway Stores, Incorporated ("Safeway"), a stockholder and the largest user of the Company's trading stamp service, formerly accounting for approximately 13% of the Company's stamp service income, has discountinued the use of such service in approximately 7% of those of its retail outlets using such service and has adopted different marketing practices and methods in such outlets. Safeway presently plans to discontinue the use of the Company's trading stamp service and adopt different marketing practices and methods in approximately an additional 17% (before giving effect to the 7% reduction mentioned above) of those of its retail outlets then using such service. Safeway has informed the Company that, although its management has no present intention of making any additional material changes in Safeway's use of such service during the period while such changes (if carried through) are being put into effect, Safeway's future course after that time will depend upon the results obtained from the changeover, the market conditions then existing and such other factors as its management may regard as relevant. Another of the Company's stockholder licensees, accounting for less than 1% of the Company's stamp service income during the fiscal year ended March 2, 1968, has discontinued the use of the Company's trading stamp service since March 2, 1968. Three of the Company's major licensees (each a stockholder), which had accounted for approximately 7% of the Company's stamp service income during the fiscal year ended March 4, 1967, discontinued the use of the Company's trading stamp service during 1967. Although the Company cannot predict with any degree of certainty what the ultimate effect on the Company's net income will be from Safeway's proposed discontinuance of such service, or from Safeway's further discontinuance of such service in a substantial number of additional outlets or in all of its other outlets using such service, or the discontinuance of such services by one or more other important licensees (no one of which accounted for more than 4% of the Company's trading stamp service income during the fiscal year ended March 2, 1968), it is anticipated that the occurrence of one or more of such events would have a materially adverse effect on the Company's net income.

The demand by merchants for trading stamp services is affected by marketing practices and consumer attitudes toward trading stamps. Some merchandising analysts have reported that use by retailers of trading stamps nationally may be declining. However, the Company's stamp service income in its fiscal year ended March 2, 1968 was approximately the same as in the previous year (see "Statement of Income and Retained Earnings" herein). The Company has no assurance of continued patronage from any of its retailer licensees.

See "Effects of Consent Decree on Company's Operations" herein for a description of a requirement that the Company present to the Court within 30 months after the completion of the Plan of Reorganization a plan to offer for sale one-third of its trading stamp business in the State of California, which one-third shall be located in a contiguous area in Southern California.

The Company maintains 84 redemption stores where savers of Blue Chip stamps may redeem them for a wide variety of merchandise or for cash.

Method of Operation

The Company's trading stamp service is used by retailers primarily as a method of promotion which will enable them to increase and maintain their volume of sales. By offering Blue Chip stamps with their sales, they seek to attract new customers and to encourage steady patronage.

An important feature of the Company's service is the general availability of its stamps to all retailers who desire the use of the stamp service. In this respect the Company's operations differ from those of other trading stamp concerns which make a general practice of not licensing more than one retailer in the same type of business within a given marketing area. This exclusive franchise practice of other stamp companies enables the retailer user to differentiate his establishment from those of his competitors and for this reason the large stamp companies which operate on this exclusive franchise basis are able to and do command a higher price for their stamp service than the Company, which makes its stamp service generally available to all retailers who desire its service. On the other hand, the Company's method of operation (which permits retailers to have the same stamp service as many of their competitors) is particularly beneficial to the many retailers which otherwise would be unable to obtain a franchise to use the stamp service of a company whose stamps have wide consumer acceptance. The promotional value of a trading stamp service is directly related to the degree of consumer acceptance of the stamp's brand name.

The Company's stamp service is licensed under agreements terminable at the will of either party upon the giving of two weeks' written notice. See "Effects of Consent Decree on Company's Operations" herein for a description of limitations on the Company's right to terminate such agreements. The licensee pays the Company for the use of its service an amount measured by the number of stamps issued to the licensee.

The licensee agrees to advertise the use of Blue Chip stamps by displaying such advertising signs as are furnished by the Company and to furnish his customers with stamp saver books and premium catalogs, both of which are supplied to him by the Company. In general, retailers offer stamps at the rate of one stamp for each 10 cents paid, although some offer extra stamps. Under California law trading stamps cannot be given in connection with the sale of alcoholic beverages or fluid milk.

Retailer Licensees

The Company licenses the use of its trading stamp service to many different types of businesses in the states of California and Nevada. However, the Company's service has been used most often in those fields of trade which are characterized by similarity in the products and services offered and a high frequency of purchase, such as retail food stores, service stations and drug stores. This is indicated by the following table which sets forth the percentage breakdown of total stamps issued by the Company during the fiscal year ended March 2, 1968 to the major categories of licensees:

Supermarkets and other retail food stores	58.5%
Service Stations	30.4
Drug Stores	5.0
Other	6.1
	100.0%

The Company's trading stamp service has widespread use among both small independent merchants and supermarket chains. Of the fourteen licensees referred to above, each of which accounted for

more than one per cent of the Company's stamp service income for the fiscal year ended March 2, 1968, twelve were supermarket chains. These twelve chains accounted for approximately 34% of the Company's stamp service income for such period with no one of them accounting for more than 13% of stamp service income (but see "General" above).

The Company has a sales force of approximately 75 field representatives located in California and Nevada who solicit new licensees and serve existing licensees.

Redemption of Trading Stamps

Under the Business and Professions Code of the State of California a stamp saver may present stamps accumulated in any amount of 100 or more to the Company for redemption in merchandise or cash. Cash redemptions represented less than one per cent of the total redemptions made by the Company during the fiscal year ended March 2, 1968.

The Company maintains 84 redemption stores located in California and Nevada. In all of these redemption stores the Company maintains inventories of merchandise from which redemptions can be made. A stamp saver who is not located within twenty-five miles of one of the Company's redemption stores can redeem stamps by mailing them directly to the Company for redemption in either cash or merchandise.

The Company currently offers to stamp savers a choice of approximately 1,500 merchandise items, most of which are nationally advertised brands. These include various household items, such as sheets, towels, housewares, electrical applicances, luggage, lamps and photography equipment, sporting goods, jewelry, furniture and various other types of merchandise which are illustrated and described in a premium catalog published each year by the Company. Approximately 9,000,000 copies of the Company's premium catalog were distributed in 1967. The number of filled stamp books required to redeem the items in the Company's latest catalog ranges from one-half to 227. The Company estimates that the average redemption involves approximately three books of stamps.

The retail value of the merchandise obtainable upon the redemption of a book of the Company's trading stamps varies somewhat depending upon the type of item selected. The Company estimates that the redemption merchandise distributed by it during the fiscal year ended March 2, 1968 represented a total retail value of approximately $126,000,000. The Company purchases its redemption merchandise from over 495 suppliers, for some of which the Company is the largest single customer.

All trading stamps issued by the Company are redeemable, regardless of the length of time they have been outstanding. The Company frequently redeems stamps which were issued many years prior to their presentation for redemption. The Company is, therefore, unable to determine with absolute certainty the percentage of its stamps issued which will ultimately be presented for redemption. For a number of years the Company has made statistical evaluations of its redemptions. Based upon analysis of such evaluations the Company presently estimates that 97.5% of all stamps issued will ultimately be redeemed. On this basis the Company maintains its financial records, files its tax returns and provides a liability account in an amount equal to the estimated cost of redeeming outstanding stamps. This redemption rate is also reflected in the charges which the Company makes for the use of its trading stamp service and the values offered in the redemption of its stamps. Although the Company believes that its redemption rate, presently estimated to be 97.5%, is reasonable, it can give no assurance that this rate will not change in the future, nor can the Company estimate the effect of any such change on its future net income. As a matter of policy the Company makes every effort to encourage and facilitate redemp-

tions because it believes that a high rate of redemption is important to the continued participation of retail merchants and their customers in its trading stamp service.

Incentive Programs

In recent years the Company has extended the application of its service to incentive programs which it creates and furnishes for industrial and commercial companies and other organizations. The programs which are designed to suit the particular needs of individual customers may involve the award of Blue Chip stamps or merchandise to employees and others for performance in meeting sales or production goals or for attendance, safety or various other objectives.

The Company presently has more than 600 customers using its incentive programs. The income from this activity was approximately $700,000 for the fiscal year ended March 2, 1968, approximately $960,000 for the year ended March 4, 1967 and approximately $680,000 for the year ended February 26, 1966.

The Company is exploring other possible applications of its stamp service as well as other types of merchandising and promotional techniques.

Effects of Consent Decree on Company's Operations

On June 5, 1967, a Consent Final Judgment ("Consent Decree") was entered in the United States District Court, Central District of California, in a civil action entitled *United States of America v. Blue Chip Stamp Company, et al.* (No. 63-1552-F), which affects the Company's future business and method of operation. Under the terms of the Consent Decree the Company is:

(a) Enjoined and restrained from:

(1) Refusing to provide a trading stamp service or imposing any limitation on such service to any person because of: (i) the presence in the same locality of any establishment operated by another person using the Company's stamp service; (ii) the rate of issue employed by such person in offering the Company's or any other person's stamps; or (iii) the use by such person of any other trading stamp service;

(2) Coercing or compelling any person: (i) to limit the rate of issue employed in offering the Company's or any other person's stamps; or (ii) to refrain from using any other trading stamp service.

(3) Having as an officer or employee any person, who, while holding such position, also serves as an officer, director or employee of any person using trading stamp services, or from having, as a director after the first meeting of the Company's stockholders following completion of this offering to Users and until June 5, 1977, any person, who, while holding such position, also serves as an officer, director or employee of any person who was a stockholder of the Company in 1956 or 1957.

(b) Ordered and directed, within 30 months after the date of completion of the reorganization, to present for the approval of the Court a plan which shall include the following terms:

(1) The Company shall offer for sale one-third of its then existing trading stamp business in the State of California. The business to be offered for sale shall be located within a contiguous geographic area within Southern California;

(2) The purchaser shall have the right, if it so elects, to redeem the Company's trading stamps within the contiguous area for the period of one year following consummation of the sale, and the Company is prohibited for such one-year period from competing in the contiguous area with the purchaser. The Company is required to offer its trading stamp service in the contiguous area following the expiration of the said one-year period.

Although the Company cannot predict with any degree of certainty what the ultimate effect will be of a sale of one-third of its trading stamp business in California, where operations account for approximately 99% of the Company's total stamp service income, and the prohibition against competing for a period of one year with the purchaser, it is anticipated that such sale and prohibition will have a materially adverse effect on the Company's net income from its trading stamp business.

Competition

The business of the Company is competitive. It experiences competition from other trading stamp companies and from companies offering other types of promotional and merchandising programs. The three major trading stamp companies which compete with the Company and which are among the largest in the United States operate on a franchise basis and do not generally license the use of their stamps by more than one of the competing retailers in a particular geographical area, whereas the Company makes its stamps available to all retailers without restriction. The Company also has a number of competitors that are substantially larger in the general field of incentive programs. The Company is unable to predict the extent to which its business may be affected in the future by competition from other trading stamp companies and from competitors in the general field of incentive programs, or the adoption of other promotional and merchandising techniques, by changes in the methods of retail distribution, by general economic developments or by changes in consumer attitudes toward trading stamps.

Employees

The Company employs approximately 1,350 people on a regular basis, approximately 1,125 of whom are employed in redemption stores and distribution centers. It also employs additional people at certain times of the year to meet seasonal requirements. Except for approximately 45 employees located at the Richmond, California facility, the Company's employees are not represented by labor unions. The Company considers its labor relations excellent.

The Company offers its employees a comprehensive program of group life, hospital, medical and long term disability insurance, some of the costs of which are borne by participating employees. The Company has a pension plan in which regular employees (including officers) who have completed two years of service and attained age 25 participate. Retirement benefits are based on an employee's compensation and years of service. The pension plan is funded by contributions made to Union Bank, Los Angeles, trustee under the plan. See Note 6 to Financial Statements.

Legislation

The Company is subject to various statutes and administrative regulations of the State of California, where the Company does most of its business. In the opinion of the Company, these statutes and administrative regulations thus far have had no materially adverse effect upon its business. The trading stamp business has historically been subjected to considerable agitation for restrictive legislation, but such efforts have resulted in only a limited amount of legislation. The Company cannot predict what the effect may be on its business of the enactment by California in the future of new statutes or regulations relating to trading stamps.

PROPERTY

The Company's principal offices are located at 5801 South Eastern Avenue, Los Angeles, California 90022, where the Company occupies approximately 25,000 square feet of space under a lease running to July 31, 1970 (with the Company having options to extend the lease until July 31, 1980).

All of the Company's redemption stores are on leased premises. While these leases vary as to their terms, the Company's present practice is to enter into leases for initial terms of ten years with renewal options for an additional period of five years.

The Company also operates two distribution centers used for the receipt, storage and distribution of redemption merchandise. These distribution centers, located in California, are:

Location	Approximate Storage Capacity in Cubic Feet	Year of Original Construction
Los Angeles	6,081,000	1947
Richmond (near San Francisco)	2,783,000	1961
Total	8,864,000	

The Richmond, California distribution center is owned by the Company in fee. The Los Angeles distribution center is leased under a lease running to July 31, 1970 (with the Company having options to extend the lease until July 31, 1980).

MANAGEMENT

The Company's executive officers and directors are as follows:

Name	Office
Donald A. Koeppel	President and Director
William F. Ramsey	Vice President, Secretary, Treasurer and Director
Frank A. Rote	Vice President
William S. Priest	Assistant Secretary
Robert E. Alexander	Director [also President and a Director of Alexander's Markets]
William H. Dyer, Jr.	Director [also President and a Director of Lucky Stores, Inc.]
Robert E. Laverty	Director [also Chairman of the Board and President and a Director of Thriftimart, Inc.]
John R. Niven	Director [also Chairman of the Board and Chief Executive Officer and a Director of Purity Stores, Inc.]
Richard Ralphs	Director [also Chairman of the Board and Chief Executive Officer and a Director of Ralphs Grocery Company]
Leonard H. Straus	Director [also President and Chief Executive Officer and a Director of Thrifty Drug Stores Co. Inc.]
Fred Von der Ahe	Director [also Manager of Corporate Affairs of Von's Grocery Co.]
Drummond Wilde	Director [also a Vice President and Secretary of Safeway Stores, Incorporated]

Each of the executive officers has been in the Company's employ for more than five years.

See "Interest of Management in Certain Transactions" herein for information concerning the use of the Company's trading stamp services by the corporations with which certain of the directors named above are affiliated. After the first meeting of the Company's stockholders following completion of the offering to Users the Consent Decree prohibits the Company from having as an officer or employee any person who, while holding such position, also serves as an officer, director or employee of any person using trading stamp services; or, until June 5, 1977, having as a director any person who, while holding such position, also serves as an officer, director or employee of any person who was a stockholder of Blue Chip Stamp Company in 1956 or 1957.

Accordingly, under present circumstances, of the directors listed above only Messrs. Donald A. Koeppel and William F. Ramsey will be eligible to serve as directors after the first meeting of the Company's stockholders following completion of the offering to Users and until June 5, 1977. It is anticipated that Management will present a list of nominees for directors of the Company at such meeting, but the identity of such persons is not now known. Messrs. Donald A. Koeppel and William F. Ramsey expect to continue as officers and directors of the Company.

Remuneration of Directors and Officers

The following table shows the aggregate remuneration from the Company during the fiscal year ended March 2, 1968 to each director and each of the three highest paid officers of the Company whose aggregate direct remuneration exceeded $30,000, the estimated annual benefits upon retirement of each such director and officer, and the aggregate direct remuneration for such year for all directors and officers as a group.

Name of Individual or Identity of Group	Capacity in Which Remuneration Was Received	Direct Aggregate Remuneration	Estimated Annual Benefits Under Pension Plan(1)
Donald A. Koeppel	President	$ 63,750	$11,088
William F. Ramsey	Vice President and Controller	37,100	9,285
J. J. Koeppel, Jr.	Vice President	35,100	8,671
All directors and officers as a group		217,850	

(1) Based upon the assumption that the recipients continue to be employed by the Company at their current salaries until the normal retirement date and that the plan is continued without modification. Mr. J. J. Koeppel, Jr. resigned June 30, 1968.

Qualified Stock Option Plan

On March 21, 1968 the directors of the Company adopted a qualified stock option plan covering 110,400 shares of its Common Stock for officers and key employees of the Company as an additional means to retain and attract competent management personnel. It is intended that all options granted under the plan will be "qualified stock options" as that term is defined in Section 422 of the Internal Revenue Code of 1954. Under the plan options may be issued to such officers and key employees of the Company and its subsidiaries as the board of directors may approve from time to time. The purchase price under each option may not be less than 100% of the fair market value of the stock covered thereby on the date the option is granted. Options granted under the plan will not be transferable except by will or the laws of descent and distribution. The options must expire not later than five years from the date of grant. The options may be exercised in four substantially equal annual installments commencing one year from the date of grant and accumulating until the expiration of the option.

No options have as yet been granted pursuant to the plan. It is anticipated that options covering approximately 86,000 shares will be granted to approximately 30 employees of the Company at the fair market value of the stock on the date of grant.

It is anticipated that after the offering of Units has commenced, options will be granted to the following persons, among others:

	Number of Shares
Donald A. Koeppel	30,000
William F. Ramsey	21,000
All directors and officers as a group	54,500

Holders of Securities

As of July 16, 1968, each of Alexander's Markets, Von's Grocery Co., Lucky Stores, Inc., Thriftimart, Inc., Market Basket, Purity Stores, Inc., Ralphs Grocery Company, Thrifty Drug Stores Co. Inc., and Safeway Stores, Incorporated, owned beneficially and of record 62,400 shares (approximately 10% each) of the Company's Common Stock, after giving effect to the merger of Blue Chip Stamp Company into the Company. Pursuant to the Plan of Reorganization approved by the Court, each such stockholder is required to transfer its shares of the Company to a separate and independent trustee acceptable to the United States Department of Justice or the Court. Each such trustee will have the power to vote the shares held by it. Such stock can be sold at any time free from the trust, but otherwise must remain in trust until June 5, 1977.

As of July 16, 1968 (after giving effect to such merger), of the ten directors of the Company, all except Messrs. Donald A. Koeppel and William F. Ramsey were directors, officers or employees of such stockholders of the Company which in the aggregate owned 499,200 shares (approximately 80%) of its outstanding Common Stock.

Messrs. Donald A. Koeppel and William F. Ramsey are being offered an aggregate of 14,750 shares of the Company's Common Stock. See "Offer to Employees" herein.

LITIGATION

There are set forth below descriptions of the material legal proceedings in which the Company is now involved and in which it has been involved within the past eight years:

1. *United States of America v. Blue Chip Stamp Company, Alexander's Markets, Lucky Stores, Inc., Market Basket, Purity Stores, Inc., Ralphs Grocery Company, Safeway Stores, Incorporated, Thriftimart, Inc., Thrifty Drug Stores Co., Inc., and Von's Grocery Co.* (United States District Court, Central District of California, Civil Action No. 63-1552-F).

On December 26, 1963, the United States filed a complaint against the Company and nine of its twelve stockholders. The complaint alleged that eight of the nine stockholders were grocery chains whose 1962 sales constituted 30% of all sales of grocery stores in California and that they and another stockholder, the largest pharmacy chain in California, had since 1955 engaged in a conspiracy in restraint of trade and to monopolize the trading stamp business in California and had monopolized said trading stamp business in California, in violation of Sections 1 and 2 of the Sherman Act (15 U.S.C. §§ 1 and 2). The complaint sought an injunction against continuation of the activities charged and it prayed, in addition, that each of the defendant retailers be required to divest itself of ownership of all stock in the Company and be enjoined from controlling or attempting to control the Company; that the Company be enjoined from issuing any trading stamps to any of the defendant retailers and the defendant retailers be enjoined from issuing any Blue Chip trading stamps to their customers.

After the complaint and answers denying the material allegations in the complaint were filed, the Government and the defendants engaged in detailed negotiations in an attempt to settle the litigation by consent decree. During these negotiations the Government afforded an opportunity to

all defendants and to all other persons expressing an interest in the case to be heard. As a result of these negotiations, three separate consent decrees were proposed, each of which was lodged with the Court. In order that interested persons might have time to study each proposed decree and to make known their views with respect to it, there was annexed to each of the decrees a stipulation providing that all signatory parties consented to entry of the particular decree after 30 days unless the Government withdrew its consent during the 30-day period.

Two prior proposed consent decrees which were approved by the government and consented to by all but two of the defendants were lodged with the Court. After considering objections the government withdrew its consent to the first proposed decree and the Court refused to approve the second proposed decree.

On April 28, 1967, a third proposed decree was lodged with the Court. This was consented to by all parties to the action and was approved by the State of California, California Grocers Association and Certified Grocers of California, Ltd. Notice was given to all persons who had previously appeared in the proceedings, including those who had appeared as "friends of the Court". After briefs in favor of and opposed to entry of this proposed decree had been filed by various persons, the decree was entered as a Final Judgment on June 5, 1967.

Thereafter, on June 19, 1967, a group of service station operators (see also *Twyman, et al. v. Blue Chip Stamp Company et al.,* hereinafter) filed a motion to intervene in the action and to vacate the judgment which was entered June 5, 1967. On July 12, 1967, Thrifty Shoppers Scrip Co., a trading stamp company, filed a similar motion to intervene and to vacate, and on July 14, 1967, Raley's, Inc., a stockholder in the Company (but not a defendant in the action) and a user of a different trading stamp service, filed a motion to intervene. Each of these proposed intervenors then had pending before the same Court an action under the antitrust laws against the Company and other defendants, each of which complaints sought damages for alleged violations of Sections 1 and 2 of the Sherman Act. Each of these actions now has been settled and dismissed. (See discussion of these actions below.)

Following the filing of briefs and the hearing of oral argument, the Court on July 31, 1967 entered an order denying all of the motions to intervene and to vacate the judgment. Appeals from these orders by Twyman et al. and Thrifty Shoppers Scrip Co. were filed with the United States Supreme Court, which on January 15, 1968 affirmed the decision of the District Court.

On August 3, 1967, the Company and the other defendants in this action lodged with the District Court a proposed Plan of Reorganization of the Company in compliance with the Final Judgment. Pursuant to the said Plan of Reorganization (as the same was modified and approved by the Court) the Units described in this Prospectus are being offered.

Under the terms of the Final Judgment and the Plan of Reorganization Blue Chip Stamp Company was merged into Blue Chip Stamps, and by the terms of the Final Judgment the Company is:

a. Enjoined and restrained from:

(1) Refusing to provide a trading stamp service or imposing any limitation on such service to any person because of: (i) the presence in the same locality of any establishment operated by another person using the Company's stamp service; (ii) the rate of issue employed by such person in offering the Company's or any other person's stamps; or (iii) the use by such person of any other trading stamp service;

(2) Coercing or compelling any person (i) to limit the rate of issue employed in offering the Company's or any other person's stamps; or (ii) to refrain from using any other trading stamp service;

(3) Having as an officer or employee any person, who, while holding such position, also serves as an officer, director, or employee of any person using trading stamp services, or from having, as a director after the first meeting of the Company's stockholders following completion of this offering to Users and until June 5, 1977, any person who, while holding such a position, also serves as an officer, director or employee of any person who was a stockholder of Blue Chip Stamp Company in 1956 or 1957.

b. Ordered and directed, within 30 months after completion of the reorganization, to present for the approval of the Court a plan which shall include the following terms:

(1) The Company shall offer for sale one-third of its then existing trading stamp business in the State of California. The business to be offered for sale shall be located within a contiguous geographic area within Southern California.

(2) A proposed purchaser of the one-third of the trading stamp business of the Company shall be permitted to acquire that portion of the business only upon the condition that it enters its appearance in the action described above and agree (i) that it will be bound by the same provisions referred to in subparagraphs (1), (2) and (3) above which are applicable to the Company, and (ii) to engage in the trading stamp business for a reasonable period of time. In addition, the purchaser shall have the right, if it so elects, to redeem within the contiguous area stamps theretofore issued by the Company for a period of one year following the consummation of a sale.

(3) During the period of one year following the consummation of a sale of the one-third of its business, the Company is prohibited from (i) knowingly allowing any person operating retail establishments in the contiguous area to issue Blue Chip stamps to customers of such establishments; or (ii) furnishing Blue Chip stamps to any person with knowledge that the stamps will be issued to customers at any retail establishment in the contiguous area; or (iii) otherwise engaging in the trading stamp business in the contiguous area except that, if the purchaser does not elect to redeem Blue Chip stamps or if the purchaser fails to perform in accordance with his redemption obligations, the Company shall have the right to redeem its outstanding stamps in said area. (Following the one year period, the Company is required to offer its trading stamp service in the contiguous area.)

Although the Company cannot predict with any degree of certainty what the ultimate effect will be of a sale of one-third of its trading stamp business in California, where operations account for approximately 99% of the Company's total stamp service income, and the prohibition against competing for a period of one year with the purchaser, it is anticipated that such sale and prohibition will have a materially adverse effect on the Company's net income from its trading stamp business. (See also "Other Potential Liability" herein.)

The Consent Decree also prohibits each of the retailer defendants after the first meeting of the Company's stockholders following completion of this offering to Users and until June 5, 1977:

(1) From having as an officer, director, or employee any person who, while holding such position, also serves as an officer, director or employee of the Company; or

(2) From exercising any right which it might acquire to vote for the election of any official of the Company; provided that a retailer defendant may cause such right to be exercised independently by a financial institution or other third party acceptable to plaintiff or approved by the Court.

2. *The Signal Companies, Inc. and Regal Stations, Inc. v. Blue Chip Stamp Company* (United States District Court, Central District of California, No. 68-927-H P.)

On June 3, 1968 The Signal Companies, Inc. (formerly Signal Oil and Gas Company, hereinafter "Signal") which markets petroleum products in California under the trade names "Hancock", "Norwalk" and "Advanced" and Signal's wholly owned subsidiary Regal Stations, Inc. (hereinafter "Regal") which markets petroleum products in California under the trade name "Regent" filed an action against the Company. The complaint alleges that the Company violated Sections 1 and 2 of the Sherman Act (15 U.S.C. §§ 1 and 2) to the alleged injury to Regal in the alleged sum of $5,000,000 and to the alleged injury to Signal in the alleged sum of $4,000,000. The complaint further alleges that the Company violated the Robinson-Patman Act to the alleged injury to Regal in the alleged sum of $250,000. The complaint prays that the plaintiffs recover treble the amount of their alleged damages. The Company has filed its answer denying all material allegations of the complaint. No prediction can be made as to the ultimate outcome of this litigation.

3. *EZY Cash Stamp Company, Inc. v. Blue Chip Stamp Company* (United States District Court, Northern District of California, No. 50143).

On October 16, 1968 EZY Cash Stamp Company, Inc., a trading stamp company which was organized in 1965 by a group of merchants in the San Jose, California area, filed an action against the Company. The complaint alleges that the Company violated Sections 1 and 2 of the Sherman Act (15 U.S.C. §§ 1 and 2) to the alleged injury of the plaintiff. The complaint alleges that the plaintiff has been injured in an amount not yet ascertained and states that when the plaintiff ascertains the amount of its alleged injury it will seek leave of court to amend the complaint accordingly. The complaint prays that plaintiff recover treble the amount of the damages which plaintiff will claim to have suffered. The Company will file an answer which denies all material allegations of the complaint. No prediction can be made as to the ultimate outcome of this litigation.

4. Settlements and Other Litigation.

a. *Twyman, et al. v. Blue Chip Stamp Company, et al.* (United States District Court, Central District of California, Civil Action No. 66-1522-H.P.); *Adaire, et al. v. Blue Chip Stamp Company, et al.* (United States District Court, Central District of California, Civil Action No. 68-928-H.P.).

The *Twyman* action was filed in February 1966 as a purported class action on behalf of service stations in the State of California owned and operated independently of the oil companies and distributors whose products they distributed. The *Adaire* case was filed June 3, 1968 as a "protective" action. Damages were claimed in these two actions in the sum of $27,787,900, for alleged violations of the Sherman Act and $6,210,358 for alleged violations of the Robinson-Patman Act, which it was prayed be trebled. On July 23, 1968, the *Twyman* and *Adaire* actions were settled for $852,855, and both complaints were dismissed with prejudice.

b. On June 3, 1968 the Company made a settlement with The Sperry and Hutchinson Company in the sum of $6,000,000. But for such settlement The Sperry and Hutchinson Company would probably

have filed its complaint seeking alleged damages in the sum of $38,000,000 trebled to $114,000,000. While in the opinion of counsel for the Company substantial defenses would have existed as to the threatened action, no prediction could be made as to the ultimate outcome if the action had been filed. In the judgment of the Company valid business considerations warranted the settlement in order to avoid protracted and expensive litigation.

c. The Raley's Litigation.

(i) *Raley's, a corporation, a stockholder of Blue Chip Stamp Company, a California corporation, for itself and for all other stockholders of said corporation similarly situated and on behalf of Blue Chip Stamp Company v. Alexander's Markets, et al.* (United States District Court, Central District of California, Civil Action No. 64-660-H.P.).

This purported to be a stockholder's derivative action brought by plaintiff which then held approximately 2% of the stock of Blue Chip Stamp Company on behalf of the Company, which was a nominal defendant, and against various of the present and former stockholders, officers and directors of the Company. There were only two other stockholders. They were not named as defendants in the action, and they (namely, Louis Stores, Inc. and All-American Markets, Inc.) filed affidavits with the Court that neither of them had authorized nor did they desire Raley's or its counsel of record in the action, or any of them, to represent them, or to appear for them or on their behalf in said action, and disclaiming such representation or any attempt at such representation, and advising that they did not desire to be bound by any judgment in said action or in any manner or to any extent to be held liable for any costs or expenses or attorneys' fees incurred or to be awarded therein.

The complaint alleged that certain present or former officers, directors and stockholders had violated Sections 1 and 2 of the Sherman Act (15 U.S.C. §§ 1 and 2) to the injury of the Company.

The prayer of the complaint requested judgment for the benefit of the Company a) in the sum of $2,000,000 which the complaint alleged was improperly distributed by way of rebate to licensees, b) for the amount of lost profits to the Company resulting from an alleged improper reduction of prices, c) for recovery of the expenses incurred by it for attorney's fees, court costs, or otherwise incurred in defense of all antitrust actions brought against the Company and for the amount paid by way of settlement or on judgment on said actions, and d) for all other damages allegedly suffered by the Company as a result of the alleged restraints of trade and competition. The complaint further prayed that the amount of the alleged damages be trebled; that the defendant shareholders be required to divest themselves of ownership of all stock in the Company and be required to transfer the stock to the Company for its par value; that the defendants be enjoined from any further distribution of earnings or funds by way of rebate or otherwise, except as a dividend; and for attorneys' fees and costs of suit. The Company and all of the other defendants filed answers to the complaint which denied that the plaintiff had any right to recover in the action.

(ii) *Raley's v. Blue Chip Stamp Company, et al.* (Los Angeles County Superior Court No. 933354).

On June 3, 1968 Raley's, the same minority stockholder, filed this action against Blue Chip Stamp Company, Blue Chip Stamps, the "Retailer defendants" referred to above under *United States of America v. Blue Chip Stamp Company*, and against the present and certain of the past directors of Blue Chip Stamp Company. The complaint prayed that the plaintiff be granted an injunction enjoining the defendants from (a) proceeding with the merger or transferring the assets of Blue Chip Stamp

Company to Blue Chip Stamps or any other company; (b) from exchanging stock of Blue Chip Stamp Company for stock of Blue Chip Stamps or any other Company; (c) from dissolving Blue Chip Stamp Company. The complaint also sought an Order compelling defendants to issue to the plaintiff 42 shares of Blue Chip Stamp Company stock at $100 par value per share. In addition the complaint prayed for damages for purported fraud in the sum of $2,500,000 and punitive damages of $1,000,000. On June 12, 1968 the Superior Court entered its order denying plaintiff's motion for a preliminary injunction to prevent the merger, the transfer of assets and exchange of stock.

(iii) *Raley's, Inc. v. Volk, et al.* (Los Angeles County Superior Court No. 931757).

On May 6, 1968, Raley's, a minority stockholder of Blue Chip Stamp Company, filed a Petition for Writ of Mandate against the Commissioner of Corporations of the State of California seeking to have set aside the decision of the said Commissioner which found, in effect, that the proposed issuance of securities following the merger is fair, just and equitable and authorized the merger of Blue Chip Stamp Company into Blue Chip Stamps. Blue Chip Stamp Company and Blue Chip Stamps were named as Real Parties In Interest in this action and appeared in opposition to the said Petition. On June 21, 1968 the Superior Court signed its Findings of Fact and Conclusions of Law and on June 26, 1968 entered its Judgment denying the Petition for Writ of Mandate. On July 12, 1968 the State District Court of Appeal denied the application of Raley's for a stay of the Commissioner's decision, and the merger was consummated on July 16, 1968.

On August 8, 1968 the Company settled all the foregoing *Raley's* litigation and obtained a dismissal with prejudice thereof, together with a general release of all claims. Under the terms of the settlement the Company paid the sum of $800,000 to Raley's. Raley's has sold all of its stock of the Company.

d. *Thrifty Shoppers Scrip Co. v. Blue Chip Stamp Company, et al.* (United States District Court, Central District of California, Civil Action No. 67-596-H.P.)

This action was filed on April 25, 1967. The complaint alleged that the Company and the same stockholders who were named defendants in *United States of America v. Blue Chip,* discussed above, violated the Sherman Act (15 U.S.C. §§ 1 and 2) to the alleged injury of the plaintiff in the alleged sum of $1,000,000. The complaint prayed for treble the alleged damages. On June 6, 1968 this action was settled for the sum of $275,000 and the complaint was dismissed. In the judgment of the Company valid business considerations warranted the settlement.

e. *Purity Stores, Inc. v. Blue Chip Stamp Company* (United States District Court, Northern District of California, No. 41698).

On August 12, 1963, Purity Stores, Inc., a stockholder in Blue Chip Stamp Company, filed an action for injunction against that company alleging that the Company and certain non-defendant alleged co-conspirators had violated Sections 1 and 2 of the Sherman Act (15 U.S.C. §§ 1 and 2) by agreeing to control the terms and conditions of the distribution of the defendant's stamps, by agreeing to maintain the defendant in a dominant position in the trading stamp business and by terminating Purity's license to use Blue Chip stamps. The defendant filed an answer to the complaint denying the allegations thereof but admitting that it had terminated the written agreement between it and plaintiff for the use by plaintiff of the defendant's trading stamp service because of the plaintiff's failure to conform to the defendant's then policy not to permit its licensees to engage in bonus or multiple-stamp programs.

On the application of the plaintiff in that action, the Court on August 13, 1963 issued a temporary restraining order, and on August 30, 1963 entered a Judgment For Preliminary Injunction providing

that pending the final hearing and determination of the action by the Court, or until further order of the Court, the defendant was enjoined from terminating the plaintiff's license contract and ordered to continue to supply its trading stamps to plaintiff without the imposition of any limit or restriction upon the rate of issue thereof. (As noted above in the discussion of *United States v. Blue Chip Stamp Company, et al.*, the Final Judgment therein, entered June 5, 1967, prohibits the Company from imposing any limit or restriction on the rate of issue of its stamps.)

The *Purity* action did not proceed further to a final hearing or determination on the merits. It was dismissed without prejudice, by stipulation of the parties filed July 25, 1966.

f. Claims for services and expenses.

Thriftimart, Inc., a stockholder of the Company, filed a claim in proceedings ancillary to *United States of America v. Blue Chip Stamp Company, et al.* for compensation for services allegedly benefitting the Company in that action. Comparable claims were filed by two other claimants, and claims were also asserted by four of the Company's stockholders for reimbursement of their out-of-pocket expenses in the event that any of the other claimants should be compensated. On October 21, 1968 the Company agreed to and the United States District Court approved a settlement of all such claims as follows:

Name of Claimant	Amount of Settlement
Thriftimart, Inc.	$ 250,000.00
California Grocers Association and Certified Grocers of California, Ltd.	200,000.00
Safeway Stores, Incorporated	24,604.66
Purity Stores, Inc.	36,311.53
Lucky Stores, Inc.	20,001.27
Market Basket	22,451.72
Howard, Prim, Smith, Rice & Downs (then attorneys for the plaintiffs in *Twyman, et al. v. Blue Chip Stamp Company* — see page 21 of prospectus)	5,000.00
Total	$ 558,369.18

In the judgment of the Company valid business considerations warranted these settlements. In the opinion of counsel for the Company any further such claims, if asserted against the Company, would be rejected by the Court.

g. In addition to the actions under the antitrust laws described above, the Company has been named a defendant in five additional actions which have alleged that the Company and its stockholders violated Sections 1 and 2 of the Sherman Act, to the injury of the plaintiffs in such actions. Four of such actions were settled and disposed of by the Company prior to trial, each for a sum that, in the opinions of the Company and its counsel, was less than would have been the cost of defense thereof. The aggregate of such settlements was not a material amount. In the fifth action referred to, the Company made a motion for summary judgment in its favor on the theory that, even if it should be assumed that there was an illegal combination and conspiracy, this plaintiff (which had been engaged in the advertising business) was not within the target area of the alleged conspiracy and had no right to recover damages. The motion for summary judgment was granted and no appeal was taken from the judgment.

There have been two actions filed against the Company which alleged that the Company had violated the California Unfair Practices Act, as a result of its pricing structure, to the injury of the plaintiffs in such actions. One of the actions was settled for a nominal sum. In the other a judgment was entered in favor of the Company after trial, and no appeal was taken.

It is not possible to predict at this time whether additional actions such as those described above might be filed or the potential liability, if any, of the Company if such litigation should be instituted, although, in the opinion of counsel for the Company, it is very likely that further such actions would be barred by the statutes of limitations.

5. Indemnity of Officers, Directors and Stockholders.

Prior to the merger of Blue Chip Stamp Company into Blue Chip Stamps, Blue Chip Stamp Company had indemnified its past and present officers, directors and stockholders and agreed to hold them harmless from claims, costs, expenses and liabilities arising out of claims asserted against Blue Chip Stamp Company or those officers, directors or stockholders based upon the organization or operations of Blue Chip Stamp Company or the acts of such persons in connection therewith, including any based on alleged violations of the antitrust laws and any arising out of the Plan of Reorganization. The Merger Agreement provides that in consideration of the transfer to it of all of the assets of Blue Chip Stamp Company, the Company shall indemnify and hold harmless Blue Chip Stamp Company and its past and present officers, directors and stockholders from any such matters. In addition, the Company has agreed to indemnify and hold harmless its own present officers, directors and stockholders from any such matters. Such indemnities are limited in that they extend only to claims or liabilities which shall have been established by final judgment of a court of competent jurisdiction or by a compromise or settlement to which the Company shall have been a party or shall have given its written approval. In the opinion of Messrs. O'Melveny & Myers, counsel for the Company, the indemnity provisions should be held valid and enforceable under California law. Because, however, questions have been raised as to these matters, counsel have recommended to the Company and the Company has agreed that prior to making any payment under the indemnity provisions it will obtain a determination of a court of competent jurisdiction to the effect that such payment may be made and, thereafter, as to any future such payments, if the indemnity provisions shall have been held lawful, a favorable opinion of its general counsel to the effect that such payment may be made. It is not possible to predict whether the Company will ever be called upon to fulfill this undertaking, nor is it possible to predict the potential liability, if any, of the Company if it should be called upon to discharge its obligations as a result of this undertaking.

6. Effects of Pending Litigation and Claims.

In the opinion of Messrs. O'Melveny & Myers, counsel for the Company, it is unlikely that the aggregate ultimate liability of the Company, if any, with respect to the claims and the actions referred to above in this "Litigation" section which have not been settled, will be material in relation to the aggregate amounts asserted in said actions and claims. In their opinion it is also unlikely that such aggregate ultimate liability would have a materially adverse effect upon the ability of the Company to continue its business and operations. However, counsel can give no assurance that the ultimate liability or the effect on the Company's business and operations will be so limited. Counsel emphasize that the foregoing represents their present views only and that these views may change in the light of subsequent developments.

INTEREST OF MANAGEMENT IN CERTAIN TRANSACTIONS

During the period from March 1, 1964 through March 2, 1968, the following corporations, each of which owns approximately 10% of the outstanding stock of the Company and all but one of which has a representative on the Company's board of directors, accounted for the dollar volume of trading stamp services set forth opposite their respective names:

Name	Dollar Amount
Alexander's Markets	$ 1,511,044
*Lucky Stores, Inc.	4,911,625
*Market Basket	5,423,123
Purity Stores, Inc.	6,555,041
Ralphs Grocery Company	8,595,489
Safeway Stores, Incorporated	43,132,781
Thriftimart, Inc.	10,144,111
*Thrifty Drug Stores Co. Inc.	7,483,143
Von's Grocery Co.	14,435,110

* Not presently using the Company's trading stamp service.

See "Management" herein for relationship of the Company's directors with the foregoing corporations and for discussion of requirements of Consent Decree and Plan of Reorganization with reference to the eligibility of persons to serve on the Board of Directors.

DESCRIPTION OF DEBENTURES

The Debentures offered hereby are to be issued under an indenture (the "Indenture") to be dated as of December 1, 1968, between the Company and Bank of America National Trust and Savings Association, Los Angeles, California, Trustee. A copy of the Indenture substantially in the form in which it will be executed is filed as an Exhibit to the Registration Statement. The statements under this caption relating to the Debentures and the Indenture are summaries and do not purport to be complete. References are to the Indenture, and wherever particular provisions are referred to, such provisions are incorporated by reference as a part of the statement made, and the statement is qualified in its entirety by such reference. Wherever a defined term is indicated, the definition thereof is contained in the Indenture.

General

The Debentures will be issued in denominations of $100 and integral multiples thereof, in fully registered form only, will bear interest from date of initial issuance at the rate of interest stated in their title, will mature on November 30, 1978 and will not be secured by any lien. Interest will be payable quarterly at the rate of 6½% per annum on March 1, June 1, September 1 and December 1, to the persons (except in the case of Debentures called for redemption between the Regular Record Date and the next succeeding interest payment date) in whose names the Debentures are registered at the close of business on the Regular Record Date for such interest installment, which shall be the fifteenth day (whether or not a business day) of the month preceding such interest payment date. (Article Two.)

Subordination of Debentures

The Debentures are subordinated and subject in right of payment to the prior payment in full of Senior Indebtedness (as hereinafter defined). Prior to December 1, 1978 the Debentures are also subordinated and subject in right of payment to the prior payment in full of all Claims or Causes of Action (as hereinafter defined) or provisions for payment of such Claims or Causes of Action. (Section 4.01.)

The Indenture provides in general that upon any distribution of the assets of the Company upon any dissolution, winding up or liquidation, reorganization, readjustment, arrangement or similar proceeding relating to the Company or its property, and certain other events involving the assignment for the benefit of creditors or the marshalling of assets and liabilities of the Company, (a) all Senior Indebtedness then due shall first be paid in full or provision made for such payment before any payment is made on account of the principal of the Debentures, and (b) if such events occur prior to December 1, 1978, in addition all Claims or Causes of Action shall first be paid in full or provision made therefor or otherwise discharged before any payment is made on account of the principal of the Debentures.

By reason of such subordination, in the event of insolvency, creditors of the Company who are holders of Senior Indebtedness or Claims or Causes of Action having priority may recover more, ratably than holders of the Debentures; and creditors of the Company who are not holders of Senior Indebtedness, Claims or Causes of Action having priority, or the Debentures, may recover less, ratably than holders of Senior Indebtedness and Claims or Causes of Action having priority, and may recover more, ratably, than holders of the Debentures.

Claims or Causes of Action

The term "Claims or Causes of Action" includes at any time a) the amount of claims asserted in lawsuits against the Company or any past or present officer, director or stockholder based upon the organization or operations of Blue Chip Stamp Company, or the acts of its officers, directors or stockholders in connection therewith, including those based on alleged violations of antitrust laws and those arising out of the Plan of Reorganization and b) claims asserted by officers, directors or stockholders of the Company based upon indemnifications of the Company holding harmless such officers, directors or stockholders from liability arising out of the claims described in a) above.

Senior Indebtedness

The term "Senior Indebtedness" shall mean the principal of (and premium, if any) and interest on a) indebtedness of the Company incurred, assumed or guaranteed, which is for money borrowed by the Company from banks, insurance companies or other lending institutions, b) renewals, extensions and refundings of any such indebtedness and c) the amount owing by the Company on Claims or Causes of Action (as defined above) as established by judgments of courts of competent jurisdiction or otherwise finally settled and agreed to by the Company.

Dividend Restrictions

The Indenture provides, in general, that the Company may not declare or pay any dividend or make any distribution (except in stock) or purchase, redeem, or otherwise acquire or retire for consideration, any of its stock a) if, during any fiscal year, such dividends or distributions would exceed 25%

of the net income of the Company for the preceding fiscal year, or b) if Claims or Causes of Action, as defined above, would exceed 50% of the Company's Stockholders' Equity or c) if the Company is in arrears in Sinking Fund payments.

Stockholders' Equity

The term "Stockholders' Equity" shall mean the stockholders' equity of the Company and its subsidiaries as determined in accordance with generally accepted accounting principles.

Redemption or Purchase

The Debentures are redeemable at any time commencing December 1, 1974 at the Company's option, as a whole or from time to time in part, upon mailing a notice of redemption not less than 30 nor more than 60 days prior to the date fixed for such redemption to the Debentureholders at their last registered addresses, at 100% of principal amount together with accrued interest to the date fixed for redemption, but the Company may not redeem, purchase or otherwise acquire any Debentures, if immediately thereafter Claims or Causes of Action (as defined above) would exceed 50% of the Stockholders' Equity of the Company.

Sinking Fund

Unless Claims or Causes of Action, as defined above, exceed 50% of the Stockholders' Equity of the Company, the Indenture requires the Company to provide for the retirement of 20% of the principal amount of the Debentures outstanding at the close of business on December 1, 1974, and on December 1, in each of the years 1975 to and including 1977, through the operation of the Sinking Fund, at the principal amount of the Debentures so retired with accrued interest to the date of redemption, provided, however, that the Company may, at its option, receive credit against Sinking Fund payments for a sum not in excess of the principal amount of (a) Debentures acquired by the Company and surrendered for cancellation, and (b) Debentures redeemed or called for redemption (otherwise than through the operation of the Sinking Fund). (Section 3.03).

The amount of any sinking fund payment in arrears shall be added to the next succeeding sinking fund payment obligation of the Company. The failure of the Company to make any sinking fund payment because of the existence of Claims or Causes of Action shall not constitute a default under the Indenture.

Federal Tax Consequences of Original Issue Discount

The Debentures, inasmuch as they are being offered as a Unit with the Common Stock, may be deemed to have been issued at an "original issue discount" as that term is defined in section 1232 of the Internal Revenue Code of 1954; that is, it may be deemed because of subsequent market valuation of the Debentures that the Unit purchase price allocable to the Debentures is less than their principal amount of $100. Users purchasing the Debentures may accordingly, upon a sale of such Debentures or upon redemption or retirement of such Debentures at a price in excess of their cost or other basis allocable to such Debentures, realize ordinary income rather than capital gains. The amount of ordinary income which might be realized is limited to a maximum amount equal to the difference between the original issue price allocable to the Debentures and their principal amount.

Events of Default, Notice of Waiver

The Indenture provides that, if an Event of Default specified therein shall have happened and be continuing, either the Trustee or the holders of 25% in principal amount of the Debentures then outstanding may declare the principal of all such Debentures to be due and payable. (Section 7.01.)

Events of Default are defined in the Indenture as being: default for 30 days in payment of any interest installment; default in payment of principal or, subject to the limitations under "Sinking Fund" herein, in the making of any sinking fund payment, when due; default for 90 days after notice to the Company by the Trustee or by the holders of 25% in principal amount of the outstanding Debentures in performance of any other covenant or agreement in the Indenture; and certain events of bankruptcy, insolvency and reorganization. (Section 7.01.)

The Indenture provides that the Trustee shall, within 90 days after the occurrence of a default, give to the Debentureholders notice of all uncured defaults known to it; provided that, except in the case of default in the payment of principal or interest on any of the Debentures or the making of any sinking fund payment, the Trustee shall be protected in withholding such notice if it in good faith determines that the withholding of such notice is in the interest of the Debentureholders. The term "default" for the purpose of this provision only shall mean the happening of any of the Events of Default specified above not including any grace period or any requirement for the giving of written notice. (Section 7.08.)

The Indenture contains a provision entitling the Trustee, subject to the duty of the Trustee during default to act with the required standard of care, to be indemnified by the holders of the Debentures before proceeding to exercise any right or power under the Indenture at the request of the Debentureholders. (Section 8.02.) The Indenture provides that the holders of a majority in principal amount of the outstanding Debentures may direct the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred on the Trustee. (Section 7.07.)

The Indenture includes a covenant that the Company will file annually with the Trustee a certificate of no default, or specifying any default that exists. (Section 5.06.)

In certain cases, the holders of a majority in principal amount of the outstanding Debentures may on behalf of the holders of all Debentures waive any past default or Event of Default except, unless theretofore cured, a default in payment of the principal and premium, if any, or interest on any of the Debentures, or any sinking fund payment with respect thereto. (Sections 7.01 and 7.07.)

Modification of the Indenture

The Indenture contains provisions permitting the Company and the Trustee, with the consent of the holders of 66⅔% in principal amount of the outstanding Debentures, to execute supplemental indentures adding any provisions to or changing or eliminating any of the provisions of the Indenture or modifying the rights of the holders of Debentures, except that no such supplemental indenture may (i) extend the fixed maturity of any Debentures, or reduce the principal amount thereof, or reduce the rate or extend the time of payment of interest thereon, or modify the provisions of the Indenture with respect to the subordination of the Debentures without the consent of the holders of affected Debentures, or (ii) reduce the aforesaid percentage of Debentures, the consent of the holders of which is required for any such supplemental indenture. (Section 11.02.)

Concerning the Trustee and Paying Agents

Principal and interest will be payable at the Corporate Trust office of the Trustee in Los Angele California, which initially shall be the principal office of Bank of America National Trust and Savin Association. Debentures may also be presented to such office for transfer or exchange.

The Company maintains banking relationships in the ordinary course of business with Bank America National Trust and Savings Association.

DESCRIPTION OF COMMON STOCK

The Company's Articles of Incorporation, as amended, authorizes a total of 1,400,000 shares one class designated "Common Stock," of the par value of $.33⅓ per share.

The holders of the shares of Common Stock from time to time outstanding have full voting right one vote for each share held of record and may apply the principle of cumulative voting at any electio of directors. They are entitled to receive such dividends as may be declared by the Board of Directo out of funds legally available therefor. Upon liquidation, dissolution or winding up of the Company, th assets legally available for distribution to stockholders shall be distributed ratably among the holders the Common Stock at the time outstanding. Holders of Common Stock have no preemptive or othe subscription or conversion rights, and no liability for further calls upon shares. The Common Stock not subject to assessment.

See "Management" — "Holders of Securities" herein for limitation on voting rights of certai stockholders.

Reference is made to "Dividend Restrictions" under the caption "Description of Debentures" here for a statement of the limitations imposed on payment of dividends by the Indenture relating to th Company's 6½% Subordinated Debentures due 1978.

Bank of America National Trust and Savings Association, Los Angeles, California, is the transf agent and Union Bank, Los Angeles, California is the registrar for the Company's Common Stock.

LEGAL OPINIONS

Legal matters in connection with the securities offered hereby will be passed upon for the Com pany by Messrs. O'Melveny & Myers, 433 South Spring Street, Los Angeles, California 90013.

EXPERTS

The financial statements and schedules included in this prospectus and elsewhere in the Regi tration Statement have been included in reliance upon the opinion of Price Waterhouse & Co., inde pendent accountants, and in reliance upon the authority of such firm as experts in auditing and accountin

OPINION OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of
Blue Chip Stamps

In our opinion, subject to the possible material adverse effect on the Company's financial position of the litigation referred to in Note 8, the accompanying balance sheet, together with the statement of income and retained earnings appearing elsewhere in this prospectus, present fairly the financial position of Blue Chip Stamps at March 2, 1968 and the results of its operations from July 1, 1960 to March 2, 1968 (after giving retroactive effect to the merger described in Note 1), in conformity with generally accepted accounting principles consistently applied. Our examination of these statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

PRICE WATERHOUSE & CO.

Los Angeles
April 16, 1968 (except as to Notes 1 and 8 for which date is August 8, 1968)

BLUE CHIP STAMPS

BALANCE SHEET — March 2, 1968

ASSETS

Current assets:	
Cash	$ 2,889,000
Marketable securities (Note 3)	70,245,000
Accounts receivable	4,369,000
Inventories (Note 4)	13,275,000
Prepaid taxes and other expenses (Note 2)	2,372,000
Total current assets	93,150,000
Property, fixtures and equipment, net (Note 5)	2,622,000
	$95,772,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Accounts payable	$ 4,149,000
Accrued compensation	716,000
Federal income tax	591,000
Liability for unredeemed trading stamps (Note 2)	67,256,000
Total current liabilities	72,712,000
Commitments and contingent liabilities (Notes 7 and 8)	
Stockholders' equity (Notes 1 and 8):	
Common stock, par value $.33⅓ per share — Authorized — 1,400,000 shares Issued and outstanding — 621,600 shares	207,000
Retained earnings	22,853,000
Total stockholders' equity	23,060,000
	$95,772,000

BLUE CHIP STAMPS

NOTES TO FINANCIAL STATEMENTS

March 2, 1968

NOTE 1 — Reorganization:

Pursuant to a Consent Final Judgment entered in the United States District Court, Central District of California, on June 5, 1967, Blue Chip Stamp Company was merged into the Company on July 16, 1968. The accompanying financial statements give retroactive effect to this merger as of March 2, 1968.

In order to comply with the Plan of Reorganization (see "Company" and "Plan of Reorganization" herein) the Company has adopted a qualified stock option plan (see "Management" — "Qualified Stock Option Plan" herein) and intends to grant options pursuant thereto to key employees covering an aggregate of 110,400 shares of its Common Stock. In addition, the Company intends to offer to sell 27,600 shares of its stock to certain of its employees at $.33⅓ per share and plans to make an offering of approximately 621,600 shares of its Common Stock to users of Blue Chip stamps other than incentive program clients and users who are presently stockholders. This offering will be made in Units, each consisting of three shares of Common Stock and $100 in principal amount of its 6½% Subordinated Debentures due 1978, for a cash consideration of $101. See "Offer to Users" and "Offer to Employees" herein.

NOTE 2 — Accounting practices:

The Company recognizes stamp service income upon issuance of its trading stamps and provides a liability account for unredeemed trading stamps consisting of the cost of merchandise and related redemption expenses. For a number of years the Company has made statistical evaluations of its redemptions. Based upon analysis of such evaluations the Company presently estimates that 97.5% of all stamps issued will ultimately be redeemed. Certain expenses related to redemptions are deducted for federal income tax purposes when stamps are redeemed. The increase (decrease) in the provision for federal income taxes attributable to the difference between the provision for redemption expenses when stamps are issued and the redemption expenses incurred when stamps are redeemed amounted to ($130,000) and ($152,000) in the years ended June 30, 1961 and 1962, respectively; to $34,000 in the eight months ended March 2, 1963; and to ($192,000), ($77,000), ($52,000), $57,000 and ($292,000) in the fifty-two/fifty-three week periods ended in 1964 through 1968, respectively. At March 2, 1968, the accumulated prepaid federal income taxes attributable to the difference described above amounted to $1,529,000.

At March 2, 1968 the liability for unredeemed trading stamps of $67,256,000 includes $57,375,000 for the cost of merchandise and $9,881,000 for redemption expenses.

NOTE 3 — Marketable securities:

Marketable securities are stated at cost (less amortization of bond premium). The composition of marketable securities at March 2, 1968 is set forth below:

	Cost	Market Value
Time deposits	$ 5,082,000	$ 5,082,000
Commercial paper	2,918,000	2,923,000
United States Treasury Bills	4,868,000	4,916,000
State and municipal obligations	43,573,000	38,363,000
Preferred and common stocks	13,804,000	12,803,000
	$70,245,000	$64,087,000

NOTE 4 — Inventories:

Opening and closing inventories, principally merchandise, for the three fifty-two/fifty-three week periods ended March 2, 1968 are as follows:

February 27, 1965	$ 8,985,000
February 26, 1966	10,889,000
March 4, 1967	14,269,000
March 2, 1968	13,275,000

Inventories are stated at the lower of cost, determined on a first-in, first-out basis, or market.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 5 — Property, fixtures and equipment:

Property, fixtures and equipment and related accumulated depreciation and amortization at March 2, 196[illegible] are as follows:

	Cost	Accumulated Depreciation and Amortization	Net
Land	$ 195,000		$ 195,000
Buildings	803,000	$ 200,000	603,000
Furniture, fixtures and equipment	3,419,000	1,919,000	1,500,000
Leasehold improvements	850,000	526,000	324,000
	$5,267,000	$2,645,000	$2,622,000

The Company provides for depreciation principally on the straight-line basis. Estimated lives used in computing depreciation and amortization are as follows:

Buildings	20 to 33 years
Furniture, fixtures and equipment	3 to 10 years
Leasehold improvements	lives of leases

Expenditures for renewals and betterments are capitalized; maintenance and repair costs are charged to income as incurred. When assets are retired or otherwise disposed of, the accounts are relieved of applicable cost and accumulated depreciation and amortization and any gain or loss on disposal is credited or charged to income.

NOTE 6 — Pension plan:

In 1965 the Company adopted a noncontributory pension plan which covers all employees meeting certain eligibility requirements. Charges to operations for the cost of the plan since adoption were as follows:

Fiscal year ended:	
February 26, 1966	$189,000
March 4, 1967	201,000
March 2, 1968	212,000

At March 2, 1968 the liability for unfunded past service benefits amounted to approximately $196,000.

NOTE 7 — Rental payments under long term leases:

As of March 2, 1968 the Company had minimum annual rental commitments, exclusive of taxes, insurance and other expenses payable directly by the Company, as follows:

Under leases expiring through March 2, 1973	$ 675,000
Under leases expiring from March 3, 1973 through March 2, 1978	672,000
Under leases expiring subsequent to March 2, 1978	176,000
	$1,523,000

NOTE 8 — Litigation and settlements subsequent to date of financial statements:

See "Litigation" herein for possible material adverse effects of litigation (including sale of one-third of the Company's California trading stamp business) in which the Company and its officers, directors and stockholders are now or may become parties and for settlements in the amount of $7,928,000 ($3,954,000 net of applicable income taxes) of four claims against the Company subsequent to the date of the financial statements.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 9 — Supplementary profit and loss information:

	Charged Directly to Income		
	Cost of Redemptions	Other	Total
	(In Thousands of Dollars)		
Fifty-two weeks ended February 26, 1966:			
Maintenance and repairs	$ 190	$ 24	$ 214
Depreciation and amortization	350	34	384
Taxes, other than income taxes —			
Payroll	305	49	354
California franchise		186	186
Real estate and personal property	205	20	225
Other	44	4	48
Rents	1,102	20	1,122
Fifty-three weeks ended March 4, 1967:			
Maintenance and repairs	274	35	309
Depreciation and amortization	339	32	371
Taxes, other than income taxes —			
Payroll	407	71	478
California franchise		392	392
Real estate and personal property	239	24	263
Other	55	5	60
Rents	1,335	22	1,357
Fifty-two weeks ended March 2, 1968:			
Maintenance and repairs	286	32	318
Depreciation and amortization	436	36	472
Taxes, other than income taxes —			
Payroll	377	71	448
California franchise		380	380
Real estate and personal property	322	20	342
Other	47	3	50
Rents	1,476	24	1,500

There were no charges for royalties or management and service contract fees.

PRELIMINARY PROSPECTUS DATED NOVEMBER 10, 1969

PROSPECTUS

contained herein is subject to completion or amendment. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any State in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such State.

1,821,240 Shares

BLUE CHIP STAMPS

Common Stock

(Par Value $1.00 Per Share)

The shares of Common Stock offered hereby are outstanding shares to be sold to the Underwriters by certain stockholders of the Company as stated herein under "Selling Stockholders". The Company will not receive any of the proceeds of the sales.

Prior to this offering there has been a limited market for the Common Stock. See "Price Range of Common Stock". The high bid price for the Common Stock in the over-the-counter market as reported for November 6, 1969 was 24¾.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public	Underwriting Discounts	Proceeds to Selling Stockholders*
Per Share	$	$	$
Total	$	$	$

* Before deducting expenses payable by the Selling Stockholders estimated at $..... In addition the Company has agreed to pay expenses estimated at $.....

The Common Stock is offered subject to prior sale when, as and if delivered to and accepted by the Underwriters named herein, and subject to the approval of certain legal matters by Messrs. Burke, Williams & Sorensen, counsel for the Company, Messrs. O'Melveny & Myers, counsel for the Selling Stockholders, and Messrs. Brown, Wood, Fuller, Caldwell & Ivey, counsel for the Underwriters. The Underwriters reserve the right to withdraw, cancel or modify such offer and to reject orders in whole or in part.

Merrill Lynch, Pierce, Fenner & Smith

Incorporated

, 1969

Until , 1970 (40 days after the first offer of the securities offered hereby to the public after the effective date of the Registration Statement), all dealers effecting transactions in the registered securities, whether or not participating in this distribution, may be required to deliver a Prospectus. This is in addition to the obligation of dealers to deliver a Prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

No person has been authorized to give any information or to make any representation not contained in the Prospectus in connection with the offering described herein, and, if given or made, such information or representation must not be relied upon as having been authorized by the Company, the Selling Stockholders or the Underwriters. This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy in any jurisdiction to any person to whom it is unlawful to make an offer or solicitation in such jurisdiction. Neither delivery of this Prospectus nor any sale made hereunder shall under any circumstances create an implication that there has been no change in the affairs of the Company since the date hereof.

TABLE OF CONTENTS

	Page
The Company	3
Capitalization	3
Statement of Income	4
Dividends	6
Price Range of Common Stock	6
Business	6
Property	13
Legal Proceedings	13
Management	14
Holders of Common Stock	18
Selling Stockholders	18
Description of Common Stock	18
Underwriting	20
Legal Opinions	21
Experts	21
Financial Statements	22

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE COMMON STOCK AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

THE COMPANY

Blue Chip Stamps is engaged primarily in furnishing a trading stamp service to retail merchants and their customers. At August 30, 1969, approximately 21,000 retailers were distributing Blue Chip stamps in over 23,000 retail outlets in California and Nevada. The Company maintains 83 redemption stores where savers of Blue Chip stamps may redeem them for a wide variety of merchandise or for cash. The Company is also engaged in the development of incentive and premium programs and, to a limited extent, supermarket games and sales continuity promotions.

The Company's principal offices are located at 5801 South Eastern Avenue, Los Angeles, California. It was incorporated in California on February 5, 1968 and succeeded by merger on July 16, 1968 to the business of Blue Chip Stamp Company, which had been incorporated in California in 1956 by a group of retail grocery chains. References to the "Company" are to Blue Chip Stamps and to its predecessor, unless the context provides otherwise.

In December 1963 the United States Department of Justice filed an action under the Sherman Act against Blue Chip Stamp Company and nine of its twelve stockholders. In June 1967 a consent final judgment (the "Consent Decree") was entered in the United States District Court providing for the reorganization of Blue Chip Stamp Company and requiring, among other things, that within 30 months after completion of the reorganization the Company present to the Court a plan for the sale of one-third of the Company's trading stamp business in the State of California. See "Business — Consent Decree and Plan of Reorganization" and "Business — Effects of Consent Decree on Company's Operations".

CAPITALIZATION

The table below sets forth the capitalization of the Company as of October 15, 1969:

Title of Class	Amount Authorized	Amount Outstanding
6½% Subordinated Debentures due 1978	$20,720,000	$10,840,400
Common Stock, par value $1.00 per share	7,000,000 shs.	4,871,110 shs.(1)

(1) Not including 552,000 shares reserved for issuance pursuant to the Company's qualified stock option plan, of which options for 332,500 shares have been granted but not exercised. See "Management".

On October 7, 1969 the Company effected a 5 for 1 split of its Common Stock. All references in this Prospectus to shares of the Company's Common Stock have been adjusted to reflect that stock split.

See Note 7 to the financial statements for information concerning the Company's obligations under long term leases.

STATEMENT OF INCOME

The following statement (except as it relates to the unaudited twenty-six week period ended
31, 1968) has been examined by Price Waterhouse & Co., independent accountants, whose opinion
appears elsewhere in this Prospectus. The statement should be read in conjunction with the

	Fiscal Year Ended		Eight Months Ended Mar. 1968
	June 30 1961	June 30 1962	
Revenues:			
Stamp service income (Note 3)	$48,450	$57,038	$43,7
Income from marketable securities:			
Interest	330	548	
Dividends	71	130	
Gains (losses) on sale of securities, net	7	66	
Other income	209	282	
	49,067	58,064	44,6
Costs and expenses:			
Cost of redemptions, consisting of merchandise and related expenses (Note 3)	40,088	48,047	35,0
Stamp pads and saver books	1,825	2,105	1,5
Advertising and other selling expenses	1,875	2,233	1,1
General and administrative expenses	874	1,297	1,0
Interest on debentures (Note 3)			
Interest on income tax settlements	391	12	
Patronage rebate			
	45,053	53,694	38,9
Income before income taxes and extraordinary item	4,014	4,370	5,6
Provision for income taxes (Note 3)	2,171	2,006	2,8
Income before extraordinary item	1,843	2,364	2,8
Extraordinary item (Note 8)			
Net income	$ 1,843	$ 2,364	$ 2,8
Average shares outstanding*	3,108	3,108	3,1
Per share*:			
Income before extraordinary item	$ .59	$ .76	$
Extraordinary item (Note 8)			
Net income (loss)	$ .59	$ .76	$
Cash dividend (Note 9)			

The note references pertain to notes to the financial statements included elsewhere in this Prospectus.

* Adjusted to give effect to the October 7, 1969 5-for-1 stock split. In addition, per share amounts have been a to provide for the dilutive effect of outstanding stock options granted February 13, 1969.

The decline in net income for the fiscal year ended February 29, 1964 was due primarily to tions in the amounts charged for the Company's trading stamp service and to a patronage rebate ma retailers. The decline in net income for the fiscal year ended March 2, 1968 was due primarily t additional costs resulting from operation of a distribution center at Rancho Cordova, California mencing September 1966; the distribution center was closed in June 1968.

cial statements and notes thereto included elsewhere in this Prospectus. In the opinion of the Com-, all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of esults of operations for the twenty-six weeks ended August 31, 1968 have been included.

	Fiscal Year Ended					Twenty-Six Weeks Ended	
eb. 29 1964	Feb. 27 1965	Feb. 26 1966	Mar. 4 1967	Mar. 2 1968	Mar. 1 1969	Aug. 31 1968	Aug. 30 1969
(Thousands Except for Amounts per Share)						(Unaudited)	
8,706	$72,305	$81,594	$92,028	$91,757	$108,449	$52,525	$63,395
1,013	1,191	1,410	1,671	1,715	2,306	1,098	1,655
262	299	317	458	523	458	229	395
129	304	31	(84)	90	332	14	56
380	461	449	603	579	938	310	605
0,490	74,560	83,801	94,676	94,664	112,483	54,176	66,106
9,480	65,070	71,470	81,854	83,797	94,703	45,531	54,140
2,507	2,320	2,010	2,041	1,942	2,273	1,142	1,363
2,176	2,170	1,829	2,091	2,221	2,376	1,063	1,060
1,538	1,338	1,217	1,899	1,938	2,112	780	1,029
					255		531
1,901							
7,602	70,898	76,526	87,885	89,898	101,719	48,516	58,123
2,888	3,662	7,275	6,791	4,766	10,764	5,660	7,983
1,073	1,158	2,809	2,507	1,348	5,120	2,965	3,980
1,815	2,504	4,466	4,284	3,418	5,644	2,695	4,003
					(3,651)	(3,428)	(378)
1,815	$ 2,504	$ 4,466	$ 4,284	$ 3,418	$ 1,993	$ (733)	$ 3,625
3,108	3,108	3,108	3,108	3,108	3,530	3,108	4,871
$ .58	$ .81	$1.44	$1.38	$1.10	$ 1.60	$ .87	$ .80
					(1.03)	(1.11)	(.08)
$ .58	$ .81	$1.44	$1.38	$1.10	$ .57	$ (.24)	$ .72
							$ .03

The Company is of the opinion that the practice of many retailer users of giving multiple stamps, ch has been widespread in portions of its territory since the summer of 1968, has contributed ificantly to subsequent increases in revenues and earnings. The Company cannot predict how long condition will exist. In addition, revenues, earnings and earnings per share are not necessarily icative of future revenues, earnings and earnings per share in view of the adverse effects of (1) a pos-e substantial decrease in the use of the Company's trading stamp service particularly by Safeway es, Incorporated and other large users and (2) a sale in the future of one-third of the Company's ling stamp business. See "Business — Retailer Users", "Business — Use of Stamps by Selling Stock-lders" and "Business — Effects of Consent Decree on Company's Operations".

DIVIDENDS

The predecessor Blue Chip Stamp Company, pursuant to a policy of its organizers and directors, paid no dividends on its stock at any time. Blue Chip Stamps was organized with the intention of paying dividends subject to the restrictions referred to under "Description of Common Stock." Under one such restriction, while the Company's debentures are outstanding, the Company may not declare cash dividends during any fiscal year in excess of 25% of net income for the preceding fiscal year; thus cash dividends which may be declared during the current fiscal year ending February 28, 1970 may not exceed $.10 per share. Quarterly cash dividends of $.03 per share were paid to stockholders of record as of July 15 and October 15, 1969. The Board of Directors will determine the advisability of future dividends in the light of such restrictions, earnings, the financial condition of the Company and other relevant factors.

PRICE RANGE OF COMMON STOCK

Since the sale of 1,626,060 shares of Common Stock to retailer users of the Company's trading stamp service in late 1968 (see "Business — Consent Decree and Plan of Reorganization"), a limited market in the Common Stock has developed in the over-the-counter market. Asked prices were not quoted regularly until the summer of 1969. Bid prices prior to that time should not necessarily be deemed to demonstrate the existence of an established trading market. The following table summarizes the range of high bid prices by calendar quarter based on quotations as reported by the National Quotation Bureau, Inc. from December 2, 1968 to November 6, 1969. Such prices do not represent actual transactions but represent quotations between dealers and do not include retail markups, markdowns or commissions.

Year	High	Low
1968		
Fourth Quarter (from December 2)	4	2
1969		
First Quarter	7⅜	4
Second Quarter	11	7
Third Quarter	17¼	11
Fourth Quarter (through November 6)	25	18

BUSINESS

Method of Operation

The Company's trading stamp service is used by retailers primarily as a method of promotion enabling them to increase and maintain their volume of sales. By offering Blue Chip stamps they seek to attract new customers and to encourage steady patronage.

An important feature of the Company's service is the general availability of its stamps to all retailers. This wide distribution contrasts with the practice followed by most trading stamp concerns of franchising only one retailer in the same type of business within a given marketing area. The large franchise stamp companies generally command higher prices for their stamp service since the franchised retailer is able to differentiate its establishment from those of its competitors. On the other hand, by using the Company's generally lower-priced service, numerous retailers are able to offer stamps which have recognized redemption value and in addition are attractive to their customers because they can be obtained from numerous business establishments.

The Company offers its trading stamp service to retailers without written agreements between the parties. Retailers may commence or discontinue the service at any time without notice. The Company is paid for the use of its service in an amount measured by the number of stamps issued.

The Company furnishes retailers with promotional material, stamp saver books and catalogs. In general, retailers offer stamps to their customers at the rate of one stamp for each 10 cents of sales, although some offer multiple stamps (more than one stamp for each 10 cents of sales). Under California law trading stamps cannot be given in connection with the sale of alcoholic beverages or fluid milk.

The Company has a sales force of approximately 80 field representatives who solicit new stamp service business and serve existing users.

While there are no published industry figures, the Company believes its trading stamp volume represents a substantial majority of the trading stamp volume in the area it serves.

Retailer Users

At August 30, 1969 approximately 21,000 retailers were distributing Blue Chip stamps in over 23,000 retail outlets in California and Nevada, the area in which the Company now operates. The Company presently plans to commence limited operations in portions of Arizona and Oregon in 1970.

The Company's trading stamp service is used by many different types of businesses. However, the service is used predominantly in those fields of trade which are characterized by similarity in the products and services offered and by a high frequency of consumer purchase, such as retail food stores and service stations. This is indicated by the following table which sets forth the percentage breakdown of total stamps issued by the Company during the fiscal years 1965 through 1969 and the twenty-six weeks ended August 30, 1969 according to the major categories of users:

	Fiscal Year Ended					Twenty-Six Weeks Ended
	Feb. 27, 1965	Feb. 26, 1966	Mar. 4, 1967	Mar. 2, 1968	Mar. 1, 1969	Aug. 30, 1969
Retail food stores	59.6%	57.3%	58.9%	58.5%	54.4%	48.8%
Service stations	27.8	29.2	29.1	30.4	36.7	43.6
Others	12.6	13.5	12.0	11.1	8.9	7.6
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

From the fiscal year ended February 27, 1965 to the fiscal year ended March 1, 1969 the number of stamps issued to retail food stores, service stations, and others increased 36.7%, 97.9% and 5.8%, respectively.

The Company believes that the practice of many retailer users of giving multiple stamps, which has been widespread in portions of its territory since the summer of 1968, has contributed significantly to subsequent increases in stamps issued, particularly to service stations. Since demand by merchants for trading stamp services is affected to a significant degree by consumer attitudes towards trading stamps and by frequently changing market practices and techniques, the Company is unable to predict what effect these factors may have on its future stamp volume.

There were sixteen retailers ("Major Users") which from March 1, 1964 through August 30, 1969 accounted for 1% or more of the stamps issued by the Company in any fiscal year. In the aggregate

they accounted for 39.4% of the stamps issued during this period. Eight of the Major Users (including three which discontinued use of the stamps in early 1967) owned approximately 10% each of the Company's outstanding Common Stock until December 1, 1968. See "Management — Transactions with Directors, Officers and Others". The remaining 60.6% of the Company's stamps were issued to more than 20,000 retailers ("All Others") each of which used less than 1% of the Company's stamp services. Following is a breakdown of these percentages by fiscal period:

	Fiscal Year Ended					Twenty-Six Weeks Ended
	Feb. 27, 1965	Feb. 26, 1966	Mar. 4, 1967	Mar. 2, 1968	Mar. 1, 1969	Aug. 30, 1969
Major Users	44.7%	42.9%	41.7%	37.6%	36.4%	33.0%
All Others	55.3	57.1	58.3	62.4	63.6	67.0
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

From the fiscal year ended February 27, 1965 to the fiscal year ended March 1, 1969 the number of stamps issued to Major Users increased 22.1% and the number of stamps issued to All Others increased 72.2%

Use of Stamps by Selling Stockholders

Of the Major Users referred to above, Safeway Stores, Incorporated ("Safeway"), Von's Grocery Co. ("Von's"), Purity Stores, Inc. ("Purity") and Thrifty Drug Stores Co., Inc. ("Thrifty Drug") are Selling Stockholders. Alexander's Markets ("Alexander's"), which has accounted for less than 1% of stamps issued, is also a Selling Stockholder. Following are the percentages of the Company's stamps issued to each of the Selling Stockholders during the five and one-half fiscal years ended August 30, 1969:

Selling Stockholders	Fiscal Year Ended					Twenty-Six Weeks Ended
	Feb. 27, 1965	Feb. 26, 1966	Mar. 4, 1967	Mar. 2, 1968	Mar. 1, 1969	Aug. 30, 1969
Safeway	12.9%	12.8%	13.7%	13.4%	11.4%	10.0%
Von's	4.8*	4.5*	4.8*	3.8*	3.3	3.1
Purity	2.6	2.4	1.7	1.5	1.3	1.1
Thrifty Drug	2.3	2.5	2.3	0.1	0.0	0.0
Alexander's	0.5	0.4	0.4	0.5	0.4	0.4

* Includes stamps issued to Shopping Bag stores, which stores were sold by Von's on June 19, 1967.

Thrifty Drug discontinued using trading stamps in July 1967 and Alexander's discontinued such usage in October 1969.

Safeway has been and is the largest user of the Company's trading stamp service. It operates approximately 545 retail outlets in California and Western Nevada of which approximately 350 presently use Blue Chip stamps. Safeway has previously discontinued use of the Company's stamps in 147 outlets, 127 of these since August 1968. Safeway has informed the Company that it presently plans during the first six months of 1970 to discontinue the use of the Company's stamps in an additional

200 of such outlets and that its use of stamps thereafter in its remaining outlets will depend on its evaluation of market conditions and other factors then existing. If Safeway carries out its planned discontinuance of the use of the Company's stamps in approximately 200 of its retail outlets, there would be a material adverse effect on the Company's revenues and earnings.

Von's and Purity have both informed the Company that although they have no present intention of discontinuing the use of the Company's trading stamp service, they do not intend to limit their future course of action which will depend upon competitive and business conditions and other factors they may deem relevant. Accordingly, either of them could discontinue or reduce its use of the Company's stamps at any time.

Redemption of Trading Stamps

The Company's stamps are redeemable for merchandise or cash. In recent years cash redemptions have represented less than one per cent of the total redemptions made by the Company.

The Company operates 83 redemption stores in California and Nevada. In all of these stores the Company maintains inventories of merchandise from which redemptions can be made. A stamp saver who is not located within twenty-five miles of one of the stores can redeem stamps by mailing them directly to the Company for redemption in either merchandise or cash. The Company estimates that the average redemption order involves approximately five filled books of 1,200 stamps each.

The Company currently offers in its catalog a choice of approximately 1,700 merchandise items, a number of which have color variations. These items include sheets, towels, housewares, electrical appliances, luggage, lamps, photographic equipment, sporting goods, jewelry, furniture and various other types of merchandise, most of which are nationally advertised brands. The items are purchased from over 500 suppliers, for some of which the Company is the largest customer. The catalog, of which approximately 9,000,000 copies were distributed in the fiscal year ended March 1, 1969, includes color photographs and descriptions of items.

The Company makes every effort to encourage and facilitate redemptions because it believes that a high rate of redemption is important to the continued participation of retail merchants and their customers in its trading stamp service. Stamps are redeemable regardless of the length of time which may elapse until they are presented for redemption. Based on statistical studies that have been continually updated for a number of years, the Company estimates that 97.5% of all stamps issued will ultimately be presented for redemption and makes appropriate provisions in its financial statements on that basis (see Note 3 to the financial statements). Although the Company believes that the 97.5% redemption rate is a reasonable estimate, it can give no assurance that this rate will not change in the future, nor can the Company estimate the effect of any such change on its future net income.

Incentive Programs

The Company creates and furnishes incentive programs for industrial and commercial companies and other organizations. The programs, which are designed to suit the particular needs of individual customers, may involve the award of Blue Chip stamps or merchandise to employees or others for performance in meeting sales or production goals or for attendance, safety or various other objectives. The Company presently has approximately 600 customers using its incentive programs. For the fiscal years ended in 1966, 1967, 1968 and 1969 the revenue from this activity approximated $680,000, $960,000, $700,000 and $900,000, respectively.

Advertising

The promotional value of a trading stamp service, the Company believes, is greatly influenced by the degree of consumer acceptance of the stamp's brand name. It utilizes radio, television, magazine and billboard advertisements directed towards the consumer.

Investments

At August 30, 1969 the Company's portfolio of marketable securities aggregated $102,699,000 at cost ($86,205,000 at market value). See Note 4 to the financial statements. The Company's present investment policy is to increase the proportion of the portfolio invested in equity securities with an emphasis on relatively high after-tax yield consistent with reasonable safety. In its continuing review of its investment portfolio the Company has the assistance of outside investment counsel.

Diversification

The Company has been investigating various opportunities for the diversification of its business through the acquisition of other businesses for cash or through the issuance of securities. Although no acquisitions have resulted to date, the Company is continuing to seek and review diversification opportunities.

Consent Decree and Plan of Reorganization

In December 1963 the United States Department of Justice filed an action under the Sherman Act against Blue Chip Stamp Company and nine of its twelve stockholders (*United States of America v. Blue Chip Stamp Company, Alexander's Markets, Lucky Stores, Inc., Market Basket, Purity Stores, Inc., Ralphs Grocery Company, Safeway Stores, Incorporated, Thriftimart, Inc., Thrifty Drug Stores Co., Inc. and Von's Grocery Co.*) in the United States District Court, Central District of California. On June 5, 1967 a Consent Decree was entered in said United States District Court providing for the reorganization of Blue Chip Stamp Company under a plan approved subsequently by the Court ("the Plan of Reorganization").

Pursuant to the Plan of Reorganization, the Company was formed as a wholly-owned subsidiary of Blue Chip Stamp Company and on July 16, 1968 Blue Chip Stamp Company was merged into the Company. In the merger, the Company issued 3,108,000 shares of its Common Stock to stockholders of Blue Chip Stamp Company. In addition, the Company sold 138,000 shares to certain officers and employees and adopted a qualified stock option plan for officers and key employees covering 552,000 shares. See "Management".

As a part of the reorganization, the Company offered an additional 3,108,000 shares of Common Stock and $20,720,000 in principal amount of its 6½% Subordinated Debentures due 1978 for sale in units to retailer users (other than stockholders) of Blue Chip stamps on a pro rata basis determined by the quantity of stamps issued to such users during the period between March 1, 1964 and June 1, 1968. The subscription price was $101 for a unit consisting of a Debenture in the principal amount of $100 and 15 shares of Common Stock. Debentures in an aggregate principal amount of $10,840,400 and 1,626,060 shares were subscribed for and issued as a result of said offering.

The Plan of Reorganization requires that the Company present to the United States District Court a plan for the disposition of 1,481,940 shares which were not subscribed for in the 1968 offering to users. The Court by an Order made on October 3, 1969 deferred the filing of such a plan. The Court's Order provides that if prior to January 31, 1970 there has been accomplished a secondary public offering by major stockholders of the Company of approximately 1,000,000 shares, the Court will

not require prior to January 31, 1971 the filing of any plan for the disposition of the unsubscribed shares. The Court's Order directs the Company not later than January 31, 1970 to report to the Court on the results of any such secondary public offering and on the changes which may have occurred in the ownership of the Company's stock. The Order also directs the Company at the same time to make application to the Court for further consideration of the requirement that the Company dispose of the unsubscribed shares. The Company expects to apply to the Court for relief from such requirement on the grounds that the offering made by this Prospectus will have achieved a wider distribution of the Company's stock as well as a substantial reduction in the aggregate percentage of the Company's stock owned by the retailer defendants in the government action referred to above. There is, however, no assurance that such relief will be granted, and any court-ordered offering of the unsubscribed shares may result in dilution of earnings on a per-share basis.

Effects of Consent Decree on Company's Operations

Under the terms of the Consent Decree the Company is:

(a) Enjoined and restrained from:

(1) Refusing to provide a trading stamp service or imposing any limitation on such service to any person because of: (i) the presence in the same locality of any establishment operated by another person using the Company's stamp service; (ii) the rate of issue employed by such person in offering the Company's or any other person's stamps; or (iii) the use by such person of any other trading stamp service;

(2) Coercing or compelling any person: (i) to limit the rate of issue employed in offering the Company's or any other person's stamps; or (ii) to refrain from using any other trading stamp service;

(3) Having as an officer or employee any person, who, while holding such position, also serves as an officer, director or employee of any person using trading stamp services, or from having as a director until June 5, 1977, any person who, while holding such position, also serves an an officer, director or employee of any person who was a stockholder of the Company in 1956 or 1957.

(b) Ordered and directed, within 30 months after the date of completion of the reorganization described above under "Consent Decree and Plan of Reorganization", to present for the approval of the Court a plan which shall include the following terms:

(1) The Company shall offer for sale one-third of its then existing trading stamp business in the State of California. The business to be offered for sale shall be located within a contiguous geographic area within Southern California;

(2) The purchaser shall have the right, if it so elects, to redeem the Company's trading stamps within such contiguous area for the period of one year following consummation of the sale, and the Company is prohibited for such one-year period from competing in such contiguous area with the purchaser. The Company is required to offer its trading stamp service in such contiguous area following the expiration of the said one-year period.

The 30 month period referred to in (b) above will commence at such date as the Court determines as the date of completion of the reorganization but not earlier than its order on the application which the Company is required to present before January 31, 1970 with respect to the secondary public offering of stock by major stockholders referred to under "Consent Decree and Plan of Reorganization".

Although the Company cannot predict with any degree of certainty what the ultimate effect would be of a sale of one-third of its trading stamp business in California (where operations presently account for approximately 99% of the Company's total stamp service income) and the prohibition against competing for a period of one year with the purchaser, such sale and prohibition would have a materially adverse effect on the Company's revenues and earnings from its trading stamp business.

Competition

The business of the Company is competitive. It experiences competition from companies offering other types of promotional and merchandising programs and from other trading stamp companies. However, the three major trading stamp companies which compete with the Company and which are among the largest in the United States operate on a franchise basis and do not generally license the use of their stamps by more than one of the competing retailers in a particular geographical area, whereas the Company makes its stamps generally available to all retailers. The Company also has a number of competitors that are substantially larger in the general field of incentive programs.

Some retailers who used the Company's trading stamp services in the past have converted all or a part of their operations to a so-called "discount" basis which conversion typically includes the elimination of trading stamps. The Company is unable to predict the extent to which its business may be affected in the future by competition from other trading stamp companies and from competitors in the general field of incentive programs, by the adoption of other promotional and merchandising techniques, by changes in the methods of retail distribution, by general economic developments, or by changes in consumer attitudes towards trading stamps. See "Business — Retailer Users" and "Business — Use of Stamps by Selling Stockholders".

Legislation

The Company is subject to various statutes and administrative regulations. In the opinion of the Company, these statutes and administrative regulations thus far have had no materially adverse effect upon its business. The trading stamp business has historically been subjected to considerable agitation for restrictive legislation, but such efforts have resulted in only a limited amount of legislation. The Company cannot predict what the effect may be on its business of the enactment in the future of new statutes or regulations relating to trading stamps.

Employees

The Company employs approximately 1,500 people on a regular basis, approximately 1,230 of whom are employed in redemption stores and distribution centers. It also employs additional people at certain times of the year to meet seasonal requirements. Except for approximately 80 employees located at the Richmond and Benicia, California facilities, the Company's employees are not represented by labor unions. The Company is a party to a proceeding under the National Labor Relations Act regarding unfair labor charges and a disputed election for union representation at one of its redemption centers involving approximately 14 employees. Nevertheless, the Company considers its labor relations excellent.

The Company offers its employees a comprehensive program of group life, hospital, medical and long term disability insurance, some of the costs of which are borne by participating employees. The Company has a pension plan in which regular employees (including officers) who have completed two years of service and attained age 25 participate. Retirement benefits are based on an employee's compensation and years of service. The pension plan is funded by Company contributions made to a trustee under the plan. See Note 6 to the financial statements.

PROPERTY

The Company's principal offices are located at 5801 South Eastern Avenue, Los Angeles, California 90022, where the Company occupies approximately 25,000 square feet of space under a lease running to July 31, 1970 (with the Company having options to extend the lease until July 31, 1980).

The Company normally leases its redemption stores for initial terms of five or ten years with renewal options for an additional period of five years.

The Company operates three distribution centers used for the receipt, storage and distribution of redemption merchandise. These distribution centers, located in California, are:

Location	Approximate Storage Capacity in Cubic Feet	Year of Original Construction
Los Angeles	6,081,000	1947
Richmond (near San Francisco)	2,795,000	1961
Benicia (near San Francisco)	1,760,000	1954
Total	10,636,000	

The Richmond distribution center is owned by the Company in fee. The Los Angeles distribution center is leased under a lease running to July 31, 1970 (with the Company having options to extend the lease until July 31, 1980). The Benicia distribution center is leased under a lease running to March 31, 1970 (with the Company having options to extend the lease until September 30, 1971).

The Company intends to extend the lease of its principal offices and its Los Angeles distribution center until July 31, 1975. It has made no decision regarding the Benicia lease.

LEGAL PROCEEDINGS

During the year ended March 1, 1969 and the twenty-six weeks ended August 30, 1969 the Company made payments aggregating $8,486,000 and $853,000, respectively, in settlement of various lawsuits and claims related to alleged violations of federal and state antitrust and other trade regulations (including the Sherman Act, the Clayton Act, and the California Unfair Practices Act) and the organization, operations and reorganization of Blue Chip Stamp Company. These settlements, less applicable income taxes of $4,835,000 and $475,000, respectively, were charged against income as extraordinary items.

The Company is a defendant in three actions pending in the United States District Court for the Northern District of California brought by EZY Cash Stamp Company, Inc. in October 1968, Bel Air Mart ("Mark Five Stamp Company") and seven individuals doing business as partners in Bel Air Markets in March 1969, and Evergreen Stamp Company in July 1969. In the Bel Air Mart action, litigation counsel for the Company are also defending the action on behalf of four stockholders of the Company's predecessor. See "Management — Transactions with Directors, Officers and Others". Each plaintiff alleges violations of the Sherman Act and the Bel Air Mart plaintiffs also allege violations of the Clayton Act. Each complaint asserts injuries in an amount not yet ascertained and seeks treble damages plus attorneys' fees and costs. The Company has filed its answer in each action denying all material assertions of the complaint.

In August 1969 two actions were filed against the Company in the United States District Court at Los Angeles, one by Douglas Oil Company of California and the other by Time Oil Co., Top Oil Co. and Richmond Sav-Mor Oil Co. Each plaintiff alleged violations of the Sherman Act, the Clayton Act and the California Unfair Practices Act and seeks treble damages together with attorneys' fees and costs. Douglas Oil in its complaint claimed damages in the amount of $1,050,000. The plaintiffs in the other action assert injuries in amounts not yet ascertained.

The actions mentioned in the two preceding paragraphs are being defended for the Company by Messrs. McCutchen, Black, Verleger & Shea and in their opinion substantial defenses may be available to the Company in each of said actions. On the basis of information currently available to them, said counsel are also of the opinion that it is unlikely that the aggregate ultimate liability of the Company, if any, with respect to such actions would be material in relation to the Company's stockholders' equity, but no prediction can be made as to their ultimate outcome.

Following the merger of its predecessor into the Company in July 1968, the Company entered its appearance in the Government's antitrust action pending in the United States District Court in Los Angeles and agreed to comply with the Consent Decree and the Court's Orders relative to the Plan of Reorganization. See "Business — Consent Decree and Plan of Reorganization" regarding any disposition of previously unsubscribed shares and "Business — Effect of Consent Decree on Company's Operations" regarding limitations on personnel and method of doing business and a plan for the sale of one-third of the Company's business to be filed within thirty months after completion of the reorganization.

MANAGEMENT

The Company's executive officers and directors are as follows:

Name	Office
Donald A. Koeppel	Chairman of the Board and President
William F. Ramsey	Executive Vice President and Director
Frank A. Rote	Vice President in Charge of Sales
Robert H. Bird	Secretary and Treasurer
William S. Priest	Controller and Assistant Secretary
Dr. Robert R. Dockson	Director (also Vice Chairman of the Board of California Savings & Loan Association)
Charles J. Futterman	Director (also Owner, Charles J. Futterman & Associates, Management Consultants, and Chairman of the Board of Food Employers Council, Inc.)
Z. Wayne Griffin	Director (also Chairman of Community Redevelopment Agency of the City of Los Angeles)
Joseph P. Hughes	Director (also President of Hughes Markets, Inc. and Chairman of the Board of Certified Grocers of California, Ltd.)
Emmett H. Jones	Director (also President of Terminal Oil Company, Industrial Engineering & Equipment Corporation and Westates Investment Co.)

Name	Office
Arthur D. MacDonald	Director (also President of Coca-Cola Bottling Company of Los Angeles)
Charles T. Munger	Director (also General Partner of Wheeler, Munger & Co., Investors, and President, Spring Street Capital Co.)
Ron Stever	Director (also Chairman of the Board of Ron Stever & Company, Consulting Actuaries)
Andrew J. Wolf	Director (also President of A & B Supermarkets, Inc., Santa Rosa, California)

Each of the executive officers has been in the Company's employ for more than five years, except for Mr. Bird, who, prior to his employment by the Company as Controller in 1968, was Treasurer of Orange Julius of America from 1966 and an audit manager with Price Waterhouse & Co. prior thereto.

All directors were first elected on February 10, 1969 except Mr. Koeppel and Mr. Ramsey who were members of the prior board.

Remuneration of Directors and Officers

The following table shows the aggregate remuneration from the Company during the fiscal year ended March 1, 1969 to each director or officer of the Company whose aggregate direct remuneration exceeded $30,000, the estimated annual benefits upon retirement of each such director or officer and the aggregate direct remuneration for such year for all directors and officers as a group.

Name of Individual or Identity of Group	Capacity in Which Remuneration Was Received	Direct Aggregate Remuneration(1)(2)	Estimated Annual Benefit Under Pension Plan(3)
Donald A. Koeppel	President	$ 74,375	$17,095
William F. Ramsey	Vice President, Secretary, Treasurer and Controller	47,000	14,775
All directors and officers as a group		207,768	

(1) Includes discretionary bonuses paid to officers with respect to the fiscal year. Effective March 1, 1969 Mr. Koeppel's and Mr. Ramsey's salaries were increased on an annual basis by $15,000 and $10,000, respectively. Effective July 1, 1969 the Company commenced paying directors who are not officers retainers at an aggregate annual rate of $32,100.

(2) In addition, in the event of Mr. Koeppel's death while employed by the Company, his heirs would receive $25,000 annually for ten years after his death. Similarly in the event of Mr. Ramsey's death while employed by the Company his heirs would receive $17,000 annually for ten years after his death.

(3) Amounts are based upon the assumption that the recipients continue to be employed by the Company at their current salaries until the normal retirement date and that the plan is continued without modification.

The Company has adopted a management incentive plan for the current fiscal year under which approximately 30 participants will share in a fund aggregating $30,960 plus 1.7% of pre-tax operating profit in excess of $6,969,000. Of the officers and directors, only Messrs. Rote and Priest are eligible to participate. Bonuses can be paid to other officers only in the discretion of the Board of Directors.

Qualified Stock Option Plan

The Company has adopted a qualified stock option plan covering 552,000 shares of its Common Stock for officers and key employees of the Company as an additional means to retain and attract competent management personnel. It is intended that all options granted under the plan will be "qualified stock options" as that term is defined in Section 422 of the Internal Revenue Code of 1954. Under the plan options may be issued to such officers and key employees of the Company and its subsidiaries as the Board of Directors may approve from time to time. The purchase price under each option may not be less than 100% of the fair market value of the stock covered thereby on the date the option is granted. Options granted under the plan are not transferable except by will or the laws of descent and distribution. The options must expire not later than five years from the date of grant. The options may be exercised in four substantially equal annual installments commencing one year from the date of grant and accumulating until the expiration of the option.

As of October 31, 1969 there were outstanding options, granted pursuant to the plan, to purchase 332,500 shares of the Company's Common Stock at a purchase price of $6.10 per share. All outstanding options were granted in February 1969 and expire in February 1974. See "Price Range of Common Stock" for recent bid prices of the Common Stock.

On October 31, 1969 options were held by officers and directors of the Company as follows:

	Number of Shares
Donald A. Koeppel	150,000
William F. Ramsey	105,000
All directors and officers as a group	279,000

Transactions With Directors, Officers and Others

Pursuant to the terms of the Consent Decree entered on June 5, 1967, 88,375 shares of Common Stock of the Company were sold to officers and directors of the Company at a price of $.06⅔ per share, including 40,000 shares to Donald A. Koeppel and 33,750 shares to William F. Ramsey. No other directors participated in such purchase. Purchasers of such shares have agreed not to sell, transfer or hypothecate the shares for specified periods of time and to offer to resell them to the Company under certain conditions; such restrictions terminate as to 20% of the shares each year until January 1, 1974, or upon the holder's death, if sooner.

Under the terms of the merger agreement with its predecessor (see "Business — Consent Decree and Plan of Reorganization" and "Legal Proceedings") the Company has indemnified each officer, director and stockholder of either the Company or its predecessor at the time of the merger or at any prior time and has agreed to hold them harmless from claims, and related costs and expenses, arising out of the organization of the predecessor or the Plan of Reorganization, or based upon alleged violations of the antitrust laws. The Company has also similarly agreed to indemnify and hold harmless its present officers and directors. It is not possible to predict the extent to which the Company may be called upon to fulfill these undertakings nor is it possible to predict the potential liability, if any, of the Company in the discharge of its obligations as a result of these undertakings.

During the three and one-half fiscal years ended August 30, 1969, the following corporations, each of which owned approximately 10% of the Company's outstanding stock until December 1, 1968 and all

but one of which were represented on the Company's Board of Directors until February 10, 1969, purchased the Company's trading stamp services as follows:

Name of Corporation	Name (Title) of Corporation's Representative on the Company's Board of Directors Until February 10, 1969†	Aggregate Amount of Stamp Services Purchased
*Alexander's Markets	Robert E. Alexander (President and Director)	$ 1,371,536
*Lucky Stores, Inc.	William H. Dyer, Jr. (President and Director)	1,496,740
*Market Basket	George A. Leonard† (Assistant Secretary and Director)	1,858,237
Purity Stores, Inc.	John R. Niven (Chairman of the Board and Chief Executive Officer)	4,791,466
Ralphs Grocery Company	Richard Ralphs (Chairman of the Board and Chief Executive Officer)	8,964,931
Safeway Stores, Incorporated	Drummond Wilde (Vice President and Secretary)	41,984,638
Thriftimart, Inc.	Robert E. Laverty†	10,595,612
*Thrifty Drug Stores Co., Inc.	Leonard H. Straus (President and Chief Executive Officer)	3,000,227
Von's Grocery Co.	Fred Von der Ahe (Manager of Corporate Affairs)	12,869,125

* Not presently using the Company's trading stamp service.

† Mr. Leonard served as a director of the Company until January 17, 1968. Mr. Laverty was prior to June 13, 1968 Vice President, and thereafter Chairman of the Board and President, of Thriftimart, Inc.

During the three and one-half fiscal years ended August 30, 1969, the following corporations, each of which owns less than 10% of the Company's outstanding stock and each of which has had one of its officers on the Company's Board of Directors commencing February 10, 1969, purchased trading stamp services as follows:

Name of Corporation	Name (Title) of Corporation's Officer on the Company's Board of Directors Commencing February 10, 1969	Aggregate Amount of Stamp Services Purchased
A & B Supermarkets, Inc.	Andrew J. Wolf (President)	$ 264,753
Hughes Markets, Inc.	Joseph P. Hughes (President)	3,639,288

HOLDERS OF COMMON STOCK

As of October 15, 1969, no stockholder owned of record and no stockholder was known by the Company to own beneficially more than 10% of the Company's outstanding Common Stock. As of that date, an aggregate of 660,290 shares, or 13.6% of the Company's outstanding Common Stock, was beneficially owned by directors and officers of the Company. Included in this number are 446,260 shares held by Wheeler, Munger & Co., a limited partnership of which Charles T. Munger is managing general partner. Ron Stever is a limited partner owning less than 5% interest in said partnership. Also included are 1,625 shares held by Redemp Co., a profit sharing trust, in which Andrew J. Wolf has a substantial interest. Messrs. Munger, Stever and Wolf are directors of the Company.

SELLING STOCKHOLDERS

The following table sets forth certain information as of October 31, 1969 with respect to the ownership of Common Stock of the Company by the Selling Stockholders. The table also indicates the shares of Common Stock to be sold by each of the Selling Stockholders, and the number of shares to be owned by each after the sale of the shares offered hereby.

Name	Shares Owned	Shares To Be Sold	Shares To Be Retained
Alexander's Markets	150,540	150,540	
Buffett Partnership Ltd.	371,700	371,700	
J. P. Guerin & Co.	331,760	100,000	231,760
Purity Stores, Inc.	264,000	100,000	164,000
Safeway Stores, Incorporated	312,000	312,000	
Thrifty Drug Stores Co. Inc.	312,000	250,000	62,000
*Von's Grocery Co.	312,000	312,000	
Wheeler, Munger & Co.	446,260	225,000	221,260
	2,500,260	1,821,240	679,020

* The stockholders of Von's have approved a proposed merger with a subsidiary of Household Finance Corporation ("Household"), subject to certain conditions. In the event said merger is consummated before the offering of shares by this Prospectus is completed, the parties to the merger intend that immediately prior to the merger Von's will transfer to Household the 312,000 shares of the Company's stock owned by Von's and that Household will become a selling stockholder hereunder in place of Von's.

Alexander's, Purity, Safeway, Thrifty Drug, and Von's each acquired shares in the merger on July 16, 1968 of Blue Chip Stamp Company into the Company. Prior to the offering made by this Prospectus but during 1969 Alexander's sold 162,460 shares and Purity sold 48,000 shares.

DESCRIPTION OF COMMON STOCK

The Company's Articles of Incorporation, as amended, authorize a total of 7,000,000 shares of one class designated "Common Stock," of the par value of $1.00 per share.

Bank of America National Trust and Savings Association, Los Angeles, California, is the transfer agent and Union Bank, Los Angeles, California is the registrar for the Company's Common Stock.

Except as set forth below the holders of the shares of Common Stock from time to time outstanding have full voting rights, one vote for each share held of record and may apply the principle of cumulative voting at any election of directors. They are entitled to receive such dividends as may be declared by the Board of Directors out of funds legally available therefor. Upon liquidation, dissolution or winding up of the Company, the assets legally available for distribution to stockholders shall be distributed ratably among the holders of the Common Stock at the time outstanding. Holders of Common Stock have no preemptive or other subscription or conversion rights, and no liability for further calls upon the shares. The Common Stock is not subject to assessment.

Under the terms of the indenture underlying the 6½% Subordinated Debentures due 1978, the Company may not declare or pay any dividend or make any distribution (except in stock) or purchase, redeem, or otherwise acquire or retire for consideration, any of its stock (a) if, during any fiscal year, such dividends or distributions would exceed 25% of the net income of the Company for the preceding fiscal year, or (b) if the Company is in arrears in sinking fund payments, or (c) if Claims or Causes of Action, as defined, would exceed 50% of the Company's stockholders' equity. The term "Claims or Causes of Action" includes at any time (i) the amount of claims asserted in lawsuits against the Company or any person or corporation who was at any time prior to December 1, 1968 an officer, director or stockholder based upon the organization or operations of Blue Chip Stamp Company, or the acts of its officers, directors or stockholders in connection therewith, including those based on alleged violations of antitrust laws, or arising out of the Plan of Reorganization and (ii) claims asserted by officers, directors or stockholders of the Company based upon indemnifications of the Company holding harmless such officers, directors or stockholders from liability arising out of the claims described in (i) above.

Under terms of the Consent Decree and the Plan of Reorganization, Alexander's Markets, Lucky Stores, Inc., Market Basket, Purity Stores, Inc., Ralphs Grocery Company, Safeway Stores, Incorporated, Thriftimart, Inc., Thirfty Drug Stores Co., Inc. and Von's Grocery Co. are each prohibited until June 5, 1977 from voting for the election of directors of the Company. However, shares of the Company's Common Stock held by any of the foregoing may be voted independently by a trustee or proxy acceptable to the United States Department of Justice or the Court. The voting restriction does not apply to purchasers of such shares.

The Plan of Reorganization further requires that if at any time prior to June 5, 1977, as a result of purchases by the Company of its shares, the aggregate of shares beneficially owned by the nine companies referred to in the preceding paragraph exceeds 43% of the sum of (a) the Company's outstanding shares and (b) the Company's shares reserved for issuance pursuant to a qualified stock option plan, the Company must present to the Court, within 60 days, a plan for disposing of a number of shares sufficient to reduce the percentage of shares beneficially owned by such nine companies below such 43%.

To enable the stockholders who were stockholders of the Blue Chip Stamp Company to sell any or all of their shares of the Common Stock of the Company in compliance with the Securities Act of 1933, the Company is required by the Plan of Reorganization to register under that Act the shares of any of such stockholders at such time or times as may be requested by any of them but not more than once in any calendar year. Following the completion of the offering made by this Prospectus, the Company will not be required to bear the expense of any such registrations.

As of October 15, 1969 Lucky Stores, Inc., Market Basket and Ralphs Grocery Company did not of record own any of the Company's stock.

UNDERWRITING

The Underwriters named below, acting through their Representative, Merrill Lynch, Pierce, Fenner & Smith Incorporated, have agreed to purchase, severally, subject to the terms and conditions of the Purchase Agreement, 1,821,240 shares of Common Stock from the Selling Stockholders. Each Underwriter will purchase the number of shares of Common Stock set forth opposite his name below, although under certain circumstances the commitments of non-defaulting Underwriters may be increased. Subject to the terms of the Purchase Agreement, the Underwriters are committed to purchase all of the shares if any are purchased.

Name	Address	Aggregate Number of Shares
Merrill Lynch, Pierce, Fenner & Smith Incorporated	70 Pine Street New York, N. Y. 10005	
Total		shs.

The Representative of the Underwriters has advised that sales of the Common Stock may be made to certain dealers at concessions of not in excess of ¢ per share. The Underwriters may allow, and such dealers may reallow, discounts of not in excess of ¢ per share on sales to certain other dealers.

The Company and the Selling Stockholders have agreed in the Purchase Agreement to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933.

The Selling Stockholders, certain officers and directors of the Company and members of their families and certain other stockholders, each of whom holds approximately 40,000 or more shares, have agreed that during a period of 90 days from the effective date of the Registration Statement they will not, without the prior written consent of the Representative of the Underwriters, directly or indirectly offer to sell, grant any option for the sale of, or otherwise dispose of any shares of Common Stock of the Company other than the shares covered by this Prospectus.

LEGAL OPINIONS

The legality of the Common Stock offered hereby will be passed upon for the Company by Messrs. Burke, Williams & Sorensen, 458 South Spring Street, Los Angeles, California, for the Selling Stockholders by Messrs. O'Melveny & Myers, 9601 Wilshire Blvd., Beverly Hills, California, and for the Underwriters by Messrs. Brown, Wood, Fuller, Caldwell & Ivey, 70 Pine Street, New York, New York. Messrs. Brown, Wood, Fuller, Caldwell & Ivey may rely upon the opinion of Messrs. Burke, Williams & Sorensen as to certain matters of California law.

EXPERTS

The financial statements and schedules included in this Prospectus and elsewhere in the Registration Statement except as they relate to the twenty-six week period ended August 31, 1968 have been included by the Company in reliance upon the opinion of Price Waterhouse & Co., independent accountants, and in reliance upon the authority of such firm as experts in auditing and accounting.

OPINION OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of
Blue Chip Stamps

In our opinion, the accompanying balance sheet and related statement of stockholders' equity, together with the statement of income appearing elsewhere in this Prospectus, present fairly the financial position of Blue Chip Stamps at August 30, 1969 and the results of its operations for the periods from July 1, 1960 to March 2, 1968, for the fiscal year ended March 1, 1969 and for the twenty-six weeks ended August 30, 1969, in conformity with generally accepted accounting principles consistently applied. Our examination of these statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

PRICE WATERHOUSE & CO.

Los Angeles, California
October 15, 1969

BLUE CHIP STAMPS

BALANCE SHEET — August 30, 1969

ASSETS

Current assets:		
Cash		$ 1,230,000
Marketable securities (Note 4)		102,699,000
Accounts receivable		6,438,000
Inventories (Note 5)		22,403,000
Prepaid taxes and other expenses (Note 3)		3,215,000
Total current assets		135,985,000
Property, fixtures and equipment, at cost (Note 3):		
Land	$ 535,000	
Buildings	840,000	
Furniture, fixtures and equipment	4,024,000	
Leasehold improvements	807,000	
	6,206,000	
Less accumulated depreciation and amortization	3,205,000	
		3,001,000
Unamortized debenture discount (Note 3)		2,609,000
		$141,595,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable		$ 9,517,000
Accrued compensation		698,000
Income taxes payable		4,004,000
Liability for unredeemed trading stamps (Note 3)		85,008,000
Total current liabilities		99,227,000
6½% Subordinated Debentures due 1978 (Note 1)		10,840,000
Commitments and contingent liabilities (Notes 7 and 8)		
Stockholders' equity, per accompanying statement (Notes 1, 2, 8 and 9):		
Common stock, par value $1.00 per share Authorized 7,000,000 shares Issued and outstanding 4,871,160 shares	$ 4,871,000	
Retained earnings	26,657,000	
Total stockholders' equity		31,528,000
		$141,595,000

BLUE CHIP STAMPS

STATEMENT OF STOCKHOLDERS' EQUITY

(Notes 1, 2, 8 and 9)

	Common Stock		Paid-in Capital	Retained Earnings
	Shares	Amount		
Balances at February 26, 1966	3,108,000	$ 207,000		$15,151,000
Net income for the fiscal year ended March 4, 1967				4,284,000
Balances at March 4, 1967	3,108,000	207,000		19,435,000
Net income for the fiscal year ended March 2, 1968				3,418,000
Balances at March 2, 1968	3,108,000	207,000		22,853,000
Sale of restricted stock to employees	138,000	9,000		
Sale of stock to users	1,626,060	109,000	$2,878,000	
Purchase of restricted stock from employees	(450)	—		
Net income for the fiscal year ended March 1, 1969				1,993,000
Balances at March 1, 1969	4,871,610	325,000	2,878,000	24,846,000
Purchase of restricted stock from employees	(450)	—		
Cash dividend				(146,000)
Transfer to common stock pursuant to an amendment to the Articles of Incorporation establishing par value of $1.00 per share		4,546,000	(2,878,000)	(1,668,000)
Net income for the twenty-six weeks ended August 30, 1969				3,625,000
Balances at August 30, 1969	4,871,160	$4,871,000	$ —	$26,657,000

BLUE CHIP STAMPS

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — Reorganization:

Pursuant to a consent final judgment entered in the United States District Court, Central District of California, on June 5, 1967, Blue Chip Stamp Company was merged into the Company on July 16, 1968. The accompanying financial statements give retroactive effect to this merger. In order to comply with the plan of reorganization, the Company during the fiscal year ended March 1, 1969 accomplished the following:

(1) Sold 138,000 shares of restricted Common Stock to certain employees. Purchasers of such shares have agreed not to sell, transfer or hypothecate the shares for specified periods of time and to offer to resell them to the Company under certain conditions; such restrictions terminate as to 20% of the shares each year until January 1, 1974, or upon the holder's death, if sooner.

(2) Adopted a qualified stock option plan covering 552,000 shares of Common Stock. Options for 332,500 shares were granted in February 1969 at $6.10 per share (fair market value at date of grant) and were outstanding at August 30, 1969. The exercise price for all options outstanding at August 30, 1969 aggregated $2,028,000. The options are exercisable in four equal annual installments beginning one year after date of grant and expire five years after such date. When the options are exercised, the excess of proceeds over par value will be credited to paid-in capital.

(3) Sold 1,626,060 shares of Common Stock and $10,840,400 principal amount of 6½% Subordinated Debentures due 1978 to retailer users of the Company's stamp services who were not then stockholders. The sale was made in units, each consisting of 15 shares of Common Stock and a Debenture in the principal amount of $100, for a cash consideration of $101 per unit. Based upon relative fair market values, it was later determined that of the $10,949,000 aggregate cash received $7,962,000 related to Debentures and $2,987,000 to Common Stock. The $2,878,000 excess of proceeds received for Common Stock over the par value thereof was credited to paid-in capital. The Debentures are subordinated to Claims or Causes of Action (as defined in "Description of Common Stock") and to borrowings from banks, insurance companies and other lending institutions. At least 20% of the Debentures must be redeemed annually beginning December 1, 1974, unless immediately thereafter Claims or Causes of Action would exceed 50% of stockholders' equity.

NOTE 2 — Recapitalization:

On September 25, 1969, the stockholders approved an amendment of the Articles of Incorporation to (a) change the authorized capital of the Company from 1,400,000 shares of Common Stock of the par value of $0.33⅓ per share to 7,000,000 shares of Common Stock of the par value of $1.00 per share and (b) split each issued and outstanding share of Common Stock of the par value of $0.33⅓ into five shares of Common Stock of the par value of $1.00 per share. The accompanying financial statements give retroactive effect to the stock split, which became effective October 7, 1969, and to the resulting transfer to the Common Stock account of $2,878,000 from paid-in capital and $1,668,000 from retained earnings.

NOTE 3 — Accounting practices:

The Company recognizes stamp service income upon issuance of its trading stamps and provides a liability account for unredeemed trading stamps consisting of the cost of merchandise and related redemption expenses. For a number of years the Company has made statistical evaluations of its redemptions. Based upon analysis of such evaluations the Company presently estimates that 97.5% of all stamps issued will ultimately be redeemed. The liability for unredeemed trading stamps of $85,008,000 at August 30, 1969 included $73,548,000 for the cost of merchandise and $11,460,000 for redemption expenses.

The Company deducts certain redemption expenses for income tax purposes when stamps are redeemed. The increase (decrease) in the provision for income taxes attributable to the difference between the provision for redemption expenses when stamps are issued and the redemption expenses incurred when stamps are redeemed amounted to ($130,000) and ($152,000) in the fiscal years ended June 30, 1961 and 1962, respectively; $34,000 in the eight months ended March 2, 1963; ($192,000), ($77,000), ($52,000), $57,000, ($292,000) and ($421,000) in the fiscal years ended in 1964 through 1969, respectively; and ($273,000) unaudited, and ($105,000) in the 26 week periods

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 3 — Accounting practices (Continued):

ended August 31, 1968 and August 30, 1969, respectively. At August 30, 1969, the accumulated prepaid income taxes attributable to the difference described above amounted to $2,055,000.

The following amounts have been charged (credited) to income for California franchise tax: $188,000 and $342,000 in the fiscal years ended June 30, 1961 and 1962, respectively; $352,000 in the eight months ended March 2, 1963; $358,000, $179,000, $186,000, $392,000, $380,000 and $326,000 in the fiscal years ended in 1964 through 1969, respectively; and ($65,000), unaudited, and $534,000 in the 26 week periods ended August 31, 1968 and August 30, 1969, respectively. Amounts based on income periods subsequent to March 2, 1968 have been allocated between the provisions for income taxes and the extraordinary items.

Provisions for income taxes have been reduced by investment tax credits, which have not been material in amount.

Expenditures for renewals and betterments of property, fixtures and equipment are capitalized; maintenance and repair costs are charged to income as incurred. When assets are retired or otherwise disposed of, the accounts are relieved of applicable cost and accumulated depreciation and amortization and any gain or loss on disposal is credited or charged to income.

The Company provides for depreciation and amortization of property, fixtures and equipment principally on the straight line basis. The estimated useful lives used in computing depreciation are as follows:

Buildings	20 to 33 years
Furniture, fixtures and equipment	3 to 10 years
Leasehold improvements	Lives of leases

Included in interest on debentures is amortization of debenture discount amounting to $90,000 for the fiscal year ended March 1, 1969, and $179,000 for the twenty-six weeks ended August 30, 1969. Debenture discount is being amortized over the term of the debentures by use of the debentures outstanding method.

NOTE 4 — Marketable securities:

Marketable securities are stated at cost (less amortization of bond premium). The cost of securities sold is determined by the first-in, first-out method. The composition of marketable securities at August 30, 1969 is set forth below:

	Cost	Market Value
Time deposits	$ 2,750,000	$ 2,750,000
Commercial paper	25,932,000	26,104,000
State and municipal obligations	41,544,000	29,921,000
Preferred and common stocks	32,473,000	27,430,000
	$102,699,000	$86,205,000

NOTE 5 — Inventories:

Beginning and ending inventories, principally merchandise, for the three fiscal years ended March 1, 1969 and the 26 week periods ended in August 1968 and 1969 are as follows:

February 26, 1966	$10,889,000
March 4, 1967	14,269,000
March 2, 1968	13,275,000
March 1, 1969	12,742,000
August 31, 1968 (unaudited)	18,019,000
August 30, 1969	22,403,000

Inventories are stated at the lower of cost, determined on a first-in, first-out basis, or market.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 6 — Pension plan:

In 1965 the Company adopted a noncontributory pension plan covering all eligible employees. Pension costs charged to income include amortization of prior service costs over a thirty year period and are funded annually. Such costs amounted to $189,000, $201,000, $212,000 and $197,000 in the fiscal years ended in 1966 through 1969, respectively, and to $106,000, unaudited, and $200,000 in the 26 weeks ended August 31, 1968 and August 30, 1969, respectively.

On September 25, 1969 the Board of Directors authorized a revision of the plan to provide for increased benefits. Provision for such revision resulted in an increase in pension costs charged to income for the 26 weeks ended August 30, 1969 of approximately $100,000.

At August 30, 1969, the liability for unfunded prior service costs amounted to approximately $431,000.

NOTE 7 — Long term lease commitments:

As of August 30, 1969 the Company had minimum annual rental commitments, exclusive of taxes, insurance and other expenses payable directly by the Company, as follows:

Under leases expiring through August 31, 1974	$ 691,000
Under leases expiring from August 31, 1974 through September 1, 1979	765,000
Under leases expiring subsequent to September 1, 1979	30,000
	$1,486,000

NOTE 8 — Legal proceedings:

During the fiscal year ended March 1, 1969 and the 26 weeks ended August 30, 1969, the Company made payments aggregating $8,486,000 (including $7,928,000, unaudited, prior to August 31, 1968) and $853,000, respectively, in complete settlement of certain lawsuits filed and other claims. These settlements, less applicable income taxes of $4,835,000 (including $4,500,000, unaudited, prior to August 31, 1968) and $475,000, respectively, were charged against income as extraordinary items.

See "Business — Effects of Consent Decree on Company's Operations" and "Legal Proceedings".

NOTE 9 — Dividend restrictions:

See "Description of Common Stock" for restrictions on payment of cash dividends.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 10 — Supplementary profit and loss information:

	Charged Directly to Income		
	Cost of Redemptions	Selling, General and Administrative Expenses	Total
		(In Thousands)	
Fiscal year ended March 4, 1967:			
Maintenance and repairs	$ 274	$35	$ 309
Depreciation and amortization	339	32	371
Taxes, other than income taxes —			
Payroll	407	71	478
Real estate and personal property	239	24	263
Other	55	5	60
Rents	1,335	22	1,357
Fiscal year ended March 2, 1968:			
Maintenance and repairs	286	32	318
Depreciation and amortization	437	36	473
Taxes, other than income taxes —			
Payroll	377	71	448
Real estate and personal property	322	20	342
Other	47	3	50
Rents	1,476	24	1,500
Fiscal year ended March 1, 1969:			
Maintenance and repairs	316	48	364
Depreciation and amortization	536	42	578
Taxes, other than income taxes —			
Payroll	418	85	503
Real estate and personal property	319	21	340
Other	64		64
Rents	1,472	19	1,491
Twenty-six weeks ended August 30, 1969:			
Maintenance and repairs	245	28	273
Depreciation and amortization	317	22	339
Taxes, other than income taxes —			
Payroll	250	53	303
Real estate and personal property	143	8	151
Other	11	3	14
Rents	753	10	763

There were no charges for royalties or management and service contract fees.

1,821,240 Shares

BLUE CHIP STAMPS

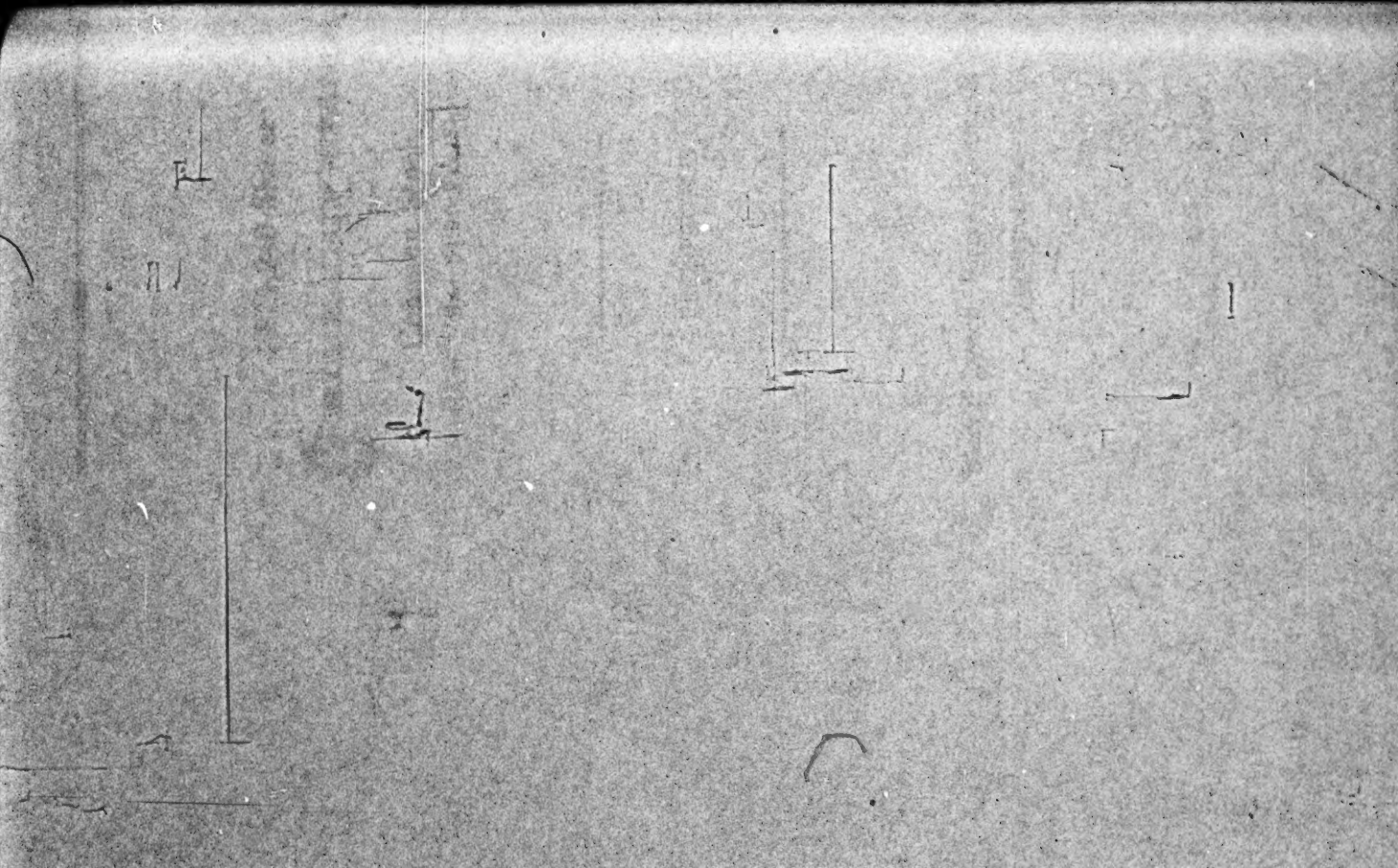
Common Stock

(Par Value $1.00 Per Share)

PROSPECTUS

Merrill Lynch, Pierce, Fenner & Smith
Incorporated

....., 1969



MANOR DRUG STORES, etc., Plaintiff,

v.

BLUE CHIP STAMPS, a corporation, et al., Defendants.
Civ. No. 70-2539.

United States District Court
For The Central District of California
[Filed May 25, 1971]

OPINION AND ORDER GRANTING DEFENDANTS' MOTION TO DISMISS

KELLEHER, District Judge.

Plaintiff brought this action for actual and exemplary damages as a result of defendants' alleged misleading representations in connection with the offer of certain securities of a corporation reorganized pursuant to a consent decree and final judgment entered by this Court in United States v. Blue Chip Stamp Co. (C.D.Calif., June 5, 1967) Civil No. 63-1552-F, an action arising under the antitrust laws against Blue Chip Stamp Co. (hereafter old Blue Chip) and nine of its shareholder corporations, named defendants herein along with certain directors of old Blue Chip and Blue Chip Stamps, a corporation, (hereafter new Blue Chip).

The consent decree provided in section V:

> Blue Chip is ordered and directed to present to the Court . . . a plan for the reorganization of Blue Chip Stamp Company . . . Upon approval of the plan by the Court Blue Chip shall make bona fide and diligent efforts to reorganize the company pursuant to the said plan;

and in section VII further provided:

> In the event that Section V becomes inapplicable, Blue Chip may also enter into a reorganization pur-

suant to a plan for the reorganization of Blue Chip Stamp Company acceptable to the Court.

The reorganization plan adopted by the Court provided, inter alia, for the formation of new Blue Chip and ordered that an:

> . . . offering of approximately 621,600 shares of its Common Stock will then be made by New Company to users of Blue Chip Stamps (who issue stamps to their retail customers as a reward for patronage) other than users who are also shareholders of Blue Chip (such users to whom such offering is made are hereinafter referred to as "Users") on a pro rata basis determined by the quantity of stamp pads issued to Users during the period subsequent to March 1, 1964, and prior to a date to be determined which will be not more than 90 days prior to the effective date of the registration statement hereinafter referred to.

The reorganization plan then went on to require registration of the offering under the Securities Act of 1933 and further prescribed that in the event portions of the offering went unsubscribed at the termination of the offering, the unsubscribed shares were to be disposed of by appropriate action of the directors of new Blue Chip. Thereafter, according to the amended complaint, an offering of new Blue Chip "units," consisting of a $100 principal amount debenture and three shares of new Blue Chip Common at a total cash consideration of $101.00, were tendered to the users by means of a prospectus dated August 29, 1968; the offering required the users to exercise their rights on or before November 29, 1968. Plaintiff alleges that the Court intended the offering to be a bargain for the users in compensation for the damages they allegedly suffered as a result of old Blue Chip's antitrust violations. However, the offering shareholders purportedly had no intention of complying in good faith with the

terms of the consent decree and permitting the users to exercise their rights under the offer and accordingly conspired to dissuade the users from purchasing the units by including misleading statements in the prospectus; specifically, the amended complaint alleges that the prospectus stated new Blue Chip's income and net earnings would be adversely affected by payment of certain claims against the company and by a substantial decrease in the use of the firm's trading stamp service. As a result of these alleged misrepresentations, plaintiff asserts that it and the other users it claims to represent were induced not to purchase the tendered units and, thereby, suffered damages which it seeks to recover by this action.

Plaintiff contends that the offering shareholders' and directors' alleged misrepresentations violate section 12 of the Securities Act of 1933 [15 U.S.C. § 77*l*] and section 10(b) of the Securities & Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Securities & Exchange Commission Rule 10b-5, promulgated thereunder. A fourth cause of action asserted under pendent federal jurisdiction alleges that plaintiff is a third party beneficiary under the consent decree and that the offering shareholders' and directors' actions breached their duty to plaintiff who may recover therefor. Defendants have moved to dismiss the amended complaint as failing to state a cognizable federal claim; for purposes of these motions, of course, the Court will take the allegations of the amended complaint as true.

PLAINTIFF'S CLAIM TO BENEFICIARY STATUS

[1] Plaintiff claims that the consent decree of June 5, 1967, sought to redress old Blue Chip's alleged antitrust violations by affording non-shareholders of old Blue Chip's trading stamp service, such as plaintiff, the opportunity to become shareholders in a newly organized Blue Chip company at what plaintiff describes as a "bargain basement price." Since the Court intended to benefit

plaintiff and other non-shareholder users, plaintiff infers that the offering shareholders owed plaintiff a duty which was breached by the alleged misrepresentations for which plaintiff may recover in Federal Court. Plaintiff's argument is as unmeritorious as it is imaginative.

[2, 3] It appears well established that a non-party to an antitrust decree cannot attempt to enforce the decree against the defendant, even though the decree was intended to directly or indirectly benefit the non-party. Accordingly, a non-party does not have standing to punish a defendant for contempt of a decree entered in an antitrust action by the United States which retains the opportunity to enforce or modify the terms of the decree. United States v. American Soc. of Composers, Auth. & Pub., 341 F.2d 1003, 1008 (2d Cir. 1965), cert. denied, 382 U.S. 877 (1965). The fact that the decree was intended to benefit certain non-parties does not confer on them an independent cause of action for violations of the decree. Control Data Corp. v. International Bus. Mach. Corp., 306 F.Supp. 839 (D.Minn. 1969), aff'd 430 F.2d 1277, 1278 (8th Cir. 1970). In *Control Data,* plaintiffs were barred from asserting defendant's alleged violations of two prior consent decrees even though plaintiffs did not per se seek to enforce the provisions of the earlier decrees and even though the decrees clearly intended to benefit defendants' competitors, including plaintiffs. The District Court reasoned that to permit private third parties to assert consent decree violations against antitrust defendants would considerably diminish their incentive to enter into such decrees as well as hinder the Government's ability to obtain consent decrees in appropriate cases. Control Data Corp. v. International Bus. Mach., *supra,* at 846.

Plaintiff's attempt to distinguish the *Control Data* case by the fact that not all plaintiffs in *Control Data* were in existence at the time of the decrees therein is untenable

since the very purpose of the decree was to stimulate competition, including the formation of new firms, in the relevant industry. Moreover, even though *Control Data* involved a private antitrust claim by the third party, there appears to be no reason why the rule of that case should not apply with equal, if not greater, force where the plaintiff, as herein, pleads a non-antitrust cause of action which depends on the prior decree. The Court concludes that if plaintiff is to have any action for defendants' alleged misrepresentations, its claim must stand or fall on the provisions of the securities laws which it asserts defendants have violated.

'33 ACT, SECTION 12

[4] Section 12 of the Securities Act of 1933 provides that any person who fraudulently sells a security in interstate commerce or through the use of the mails ". . . shall be liable to the person purchasing such security. . . ." See Greater Iowa Corp. v. McLendon, 378 F.2d 783, 789, 790 (8th Cir. 1967), affirming the dismissal of an issuer's complaint attacking the validity of minority shareholders' voting trust and stating that § 12(2) was not designed to afford protection to persons who are not investors nor those not in privity with them. Slack v. Stiner, 358 F.2d 65 (5th Cir. 1966). Slavin v. Germantown Ins. Co., 174 F.2d 799 (3d Cir. 1949), rev'g on other grounds 74 F.Supp. 876 (E.D.Pa.1947). Since this section of the Act expressly limits recovery to private litigants who qualify as "purchasers," it clearly has no application to the present action where the gravamen of the amended complaint is that due to defendants' alleged fraud plaintiff was induced not to purchase the offered securities.

'34 ACT, SECTION 10 AND RULE 10b-5

[5] Section 10 of the '34 Act makes unlawful the use of ". . . any manipulative or deceptive device or con-

trivance in contravention of such rules and regulations as the [Securities & Exchange] Commission may prescribe. . . ." Thereunder, the Commission has promulgated Rule 10b-5, which provides:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange.
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, *in connection with the purchase or sale of any security.* (emphasis added) [17 C.F.R. § 240.10b-5]

Both parties state that the Ninth Circuit Court of Appeals has not had occasion to rule whether an offeree, such as plaintiff, who has not in fact purchased or sold securities as a result of conduct fraudulent within the meaning of the Rule, may recover damages in a private civil action. There has, however, been considerable discussion of the problem elsewhere.

The watershed case appears to be Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952), cert. denied, 343 U.S. 456 (1952), holding that Rule 10b-5 does not sanction private recovery by a minority shareholder who complained of an insider's sale of corporate control without affording the minority shareholders an opportunity to sell their shares at the same price. However, to fully effectu-

ate the purpose of the Rule, the *Birnbaum* decision has generally been given a fairly restrictive interpretation by limiting its application to situations where the plaintiff was not a party to a purchase or sale transaction. See the dissent of Frank, J., in Joseph v. Farnsworth Radio & Television Corp., 198 F.2d 883 (2d Cir. 1952). Indeed the exceptions or limitations to an across the board application of the *Birnbaum* doctrine are legion, usually resting upon a liberal construction of what constitutes a purchase or sale for purposes of Rule 10b-5; thus, for example, where defrauded sellers are induced or forced to postpone their sale, an action under Rule 10b-5 will lie, Stockwell v. Reynolds & Co., 252 F.Supp. 215 (S.D.N.Y. 1965), Opper v. Hancock Securities Corp., 250 F.Supp. 668 (S.D.N.Y. 1966), aff'd 367 F.2d 157 (2d Cir. 1966); a minority shareholder was deemed a forced seller for purposes of Rule 10b-5 even though he had neither accepted defendant's tender offer nor surrendered his stock pursuant to a "short form" merger, Vine v. Beneficial Finance Co., Inc., 374 F.2d 627 (2d Cir. 1967), cert. denied, 389 U.S. 970 (1967); nor does it appear a consummated purchase or sale is required to invoke operation of the Rule, Commerce Reporting Co. v. Puretec, Inc., 290 F.Supp. 715, 718 (S.D.N.Y. 1965). Without question, such broad interpretations of the Rule are both sound and necessary in order to vitalize the antifraud purposes of the Rule and the securities laws. S.E.C. v. National Securities, Inc., 393 U.S. 453 (1969).

Nonetheless, the Court considers the Rule's application properly limited to situations where the defrauded party can show actual damages, not merely the loss of a possible gain contingent upon factors which never came into existence. 15 U.S.C. § 78bb(a). Plaintiff's case aptly demonstrates the soundness of so limiting operation of the Rule; the causal nexus between defendants' alleged misrepresentations and plaintiff's failure to purchase the

Blue Chip "units" depends upon a number of highly uncertain factors such as proof that but for defendants' misrepresentations plaintiff would have, indeed, purchased the offered "units;" the Court doubts that plaintiff, if permitted to maintain this action, could satisfactorily carry the burden of such proof; in view of this uncertainty, damages herein appear highly speculative. Kremer v. Selheimer, 215 F.Supp. 549, 552, 553 (E.D.Pa. 1963). This uncertainty is not, it is believed, peculiar to plaintiff's case but applies to any party who, like plaintiff, has not in fact entered into a transaction having the effect of a purchase or sale of securities; since the securities laws do not sanction recovery for losses based on speculation or conjecture, the Court concludes that a party in plaintiff's position is not entitled to an action under these laws.

None of the numerous cases cited by plaintiff persuades the Court that the *Birnbaum* requirement of a purchase or sale has been discarded as an essential element for maintenance of an action under Rule 10b-5. Despite some fairly extensive criticism of the requirement and predictions of its pending "demise," Entel v. Allen, 270 F.Supp. 60 (S.D.N.Y. 1967), Lowenfals, "The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5," 54 Va.L.Rev. 268 (1968), the Court finds ample authority that the *Birnbaum* requirement retains validity and represents sound policy. Iroquois Industries, Inc. v. Syracuse China Corp., 417 F.2d 963, 967 (2d Cir. 1969), cert. denied, 399 U.S. 909 (1970). Greenstein v. Paul, 400 F.2d 580, 581 (2d Cir. 1968). 3 Loss, Securities Regulation (2d ed. 1961) 1469. 6 Loss, Securities Regulation (Supplement 1969) 3620.

Upon the foregoing, IT IS HEREBY ORDERED that defendants' motions to dismiss are granted and the amended complaint is dismissed with prejudice.

IT IS FURTHER ORDERED that the Clerk of this Court send, by United States mail, copies of this opinion and order to all counsel.

Dated: May 25, 1971

ROBERT J. KELLEHER

Robert J. Kelleher
United States District Court

[Filed June 17, 1971]

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF AMERICA

(caption omitted in printing)

NOTICE OF APPEAL

Notice is hereby given that MANOR DRUG STORES AND ALL OTHER USERS OF BLUE CHIP STAMPS WHO WERE ENTITLED BUT FAILED TO PURCHASE STOCK OF BLUE CHIP STAMPS, ON BEHALF OF THEMSELVES AND ALL OTHER PERSONS SIMILARLY SITUATED, Plaintiffs, above named, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the Order Granting Defendants' Motions to Dismiss and Dismissing Plaintiffs' Complaint with Prejudice, entered in this action on the 26th day of May, 1971.

The Defendants and their counsel of record are as follows:

Defendant, MARKET BASKET, by McCutchen, Black, Verleger & Shea and all other defendants are represented by O'Melveny & Myers.

Dated: June 15, 1971.

J. J. BRANDLIN, JAMES E. RYAN
and RAY E. MCALLISTER

By JAMES E. RYAN
Attorneys for Plaintiffs

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MANOR DRUG STORES AND ALL OTHER USERS OF BLUE CHIP STAMPS WHO WERE ENTITLED BUT FAILED TO PURCHASE STOCK OF BLUE CHIP STAMPS, ON BEHALF OF THEMSELVES AND ALL OTHER PERSONS SIMILARLY SITUATED,

Plaintiffs-Appellants,

vs.

BLUE CHIP STAMPS, a corporation, BLUE CHIP STAMP COMPANY, a merged corporation, LUCKY STORES, INC., MARKET BASKET, a corporation, PURITY STORES, INC., RALPHS GROCERY COMPANY, a corporation, SAFEWAY STORES, INC., THRIFTIMART, INC., THRIFTY DRUG STORES CO., INC., VONS GROCERY CO., a corporation, ROBERT E. ALEXANDER, DONALD A. KOEPPEL, LEONARD H. STRAUS, WILLIAM F. RAMSEY, ROBERT E. LAVERTY, RICHARD RALPHS, JOHN R. NIVEN, FRED VON DER AHE,

Defendants-Appellants.

No. 71-2223
OPINION

[Filed October 15, 1973]

Appeal from the United States District Court
for the Central District of California

Before: BROWNING, HUFSTEDLER, and CHOY, Circuit Judges

BROWNING, Circuit Judge:

The district court dismissed appellants' complaint under section 10(b) of the Securities Exchange Act of 1934,[1] 15 U.S.C. § 78j(b), and Securities and Exchange Commission Rule 10b-5,[2] claiming damages for alleged fraud in connection with an offering of stock of appellee Blue Chip Stamps to appellant and the class it seeks to represent. The court held that because appellant and other members of the class did not purchase the stock they lacked standing to sue under the rule announced in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952).[3] We conclude that it does not appear "beyond doubt" that appellant "can prove no set of facts in

---

[1]Section 10(b) of the Act provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

. . . .

(b) To use or employ, *in connection with the purchase or sale of any security* registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. (Emphasis added.)

[2]The Rule provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person *in connection with the purchase or sale of any security*. (Emphasis added.)

[3]This court adopted the *Birnbaum* rule in Mount Clemens Industries, Inc. v. Bell, 464 F.2d 339 (9th Cir. 1972). *See also* Lanning v. Serwold, 474 F.2d 716 (9th Cir. 1973); Walling v. Beverly Enterprises, F.2d (9th Cir. April 9, 1973).

port of [its] claim which would entitle [it] to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). We therefore reverse.

The alleged facts are as follows.[4]

In 1963 the United States filed a complaint charging Blue Chip Stamp Company, Thrifty Drug Stores Co., Inc., and eight grocery chains with conspiracy to restrain trade and monopolization in the trading stamp business in California, in violation of the Sherman Act. This litigation was settled in 1967 by entry of a consent decree. *See United States v. Blue Chip Stamp Co.*, 272 F. Supp. 432 (C.D. Calif. 1967).

The defendants in the antitrust suit, other than Blue Chip Stamp Company, were major California retail merchandisers who used Blue Chip stamps to stimulate patronage in their businesses. They owned 90 per cent of Blue Chip Stamp Company's stock.

Other retailers who used Blue Chip stamps in their business but owned no stock in Blue Chip Stamp Company (a group that includes appellant and others in the class it seeks to represent) appear before the court in the antitrust proceeding as amicus curiae. They contended that Blue Chip Stamp Company was to have been a non-profit venture on behalf of all users of Blue Chip stamps, and that they (the non-stockholding users) in fact owned an equitable interest in Blue Chip Stamp Company and in the $20,000,000 in profits it had accumulated. They asked that this interest be recognized in the decree.

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[4]Some minor details are drawn from material submitted by plaintiff-appellant to this court. They are appropriately considered as reflecting the nature of the facts that might have been established under the allegations of the complaint. *See* Herpich v. Wallace, 430 F.2d 792, 809 (5th Cir. 1970); Shell v. Hensley, 430 F.2d 819, 822 n.8 (5th Cir. 1970).

These claims and contentions on behalf of the non-stockholding retail users of Blue Chip stamps "prompted the provisions" of the consent decree requiring the reorganization of Blue Chip Stamp Company. Under the reorganization plan eventually approved, Blue Chip Stamp Company was to be merged into a new company—Blue Chip Stamps. The defendant stockholder-users were to be divested of 55 percent of their interest in the enterprise. This was to be accomplished by issuing to others 55 percent of the common stock of the new company; 621,600 shares of the common stock of the new company were to be offered to the retail users of Blue Chip stamps who were not stockholders of the old company. The shares were to be offered on a pro-rata basis determined by the quantity of stamps issued to each of these non-stockholding users during a designated period. The offering was to be made in units consisting of three shares of common stock and a $100 debenture for a cash payment of $101. Any of the 621,600 shares not purchased by the non-stockholding users were to be sold on the open market.

The offer of debentures and stock to non-stockholding users was intended by the court and government to be, and was, a bargain. Each unit offered to the non-stockholding user for $101 had a reasonable market value of $315, as defendant-appellees knew.

Users who were stockholders in the old company (including the defendant-appellees in this case)[5] did not want the non-stockholding users to exercise their right to purchase stock in the new company. To accomplish their purpose they caused to be prepared and circulated a prospectus "calculated to mislead and dissuade users

[5]Defendant-appellees are Thrifty Drug Stores Co., Inc., seven of the eight grocery chains that were defendants in the antitrust suit, the old Blue Chip Stamp Company, the new Blue Chip Stamp Corporation, and the members of the board of directors of the latter.

not knowledgeable of the true value of said shares from purchasing said shares." The prospectus repeatedly emphasized certain "Items of Special Interest" as having an adverse effect upon the value of the offered stock.[6] "Constant reference to said items was intended to, and did cause plaintiffs to be misled as to the true value of said shares." When defendant-appellees offered "their own" shares to the public a year later,[7] the prospectus then issued made no reference to any of these "Items of Special Interest," although they were as relevant (or irrelevant) on the date of the second prospectus as they had been on the date of the first.

Defendant-appellees, by these and other means, intended to and did mislead plaintiff-appellant and other user-offerees as to value of the stock. Plaintiff-appellant and others in the class it represents, relying upon these representations, "were induced and did, in fact, not accept said offer and purchase said Units," and were thereby damaged in the amount of the difference between the offering price of the units and their fair market value.

We are not satisfied that these allegations establish on their face that appellant is barred from maintaining

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[6]One such item was the pendency of claims against the company said to "aggregate approximately $29,000,000." Defendant-appellees allegedly knew the claims "were of insignificant merit"; they were settled for less than $1,000,000.

In addition to reference to the "Items of Special Interest," the complaint alleges other misleading statements, including an estimate that 97½% of the Blue Chip Stamps issued by the new company would be redeemed when historically less than 90% were redeemed. This alleged misrepresentation "resulted in an understatement of earnings on stamp sales for the year prior to the offering of Six Million Dollars ($6,000,000) or about eighty per cent (80%)."

[7]It is unclear from the complaint whether the unsold shares originally offered to non-stockholding users were eventually sold, and at what price. The complaint mentioned sales by defendants of "their own" shares, although plaintiff-appellant's brief indicates that the same shares offered to them "were offered to the general public one year later." The facts may be resolved in further proceedings.

the action by the judicially created "purchaser-seller" prerequisite to standing to sue for damages under section 10(b) and Rule 10b-5.

The complaint alleges the use of a fraudulent scheme involving untrue statements and omissions in offering securities of Blue Chip Stamps for sale.

The statute and rule were intended to protect the purity of stock transactions from just such manipulative and deceptive practices that deprive potential investors of a reasonable opportunity to make informed and intelligent investment decisions.[8] It is obviously irrelevant to this purpose that the object of the deceptive practices was to prevent purchases rather than to induce them.[9] And Congress and the Commission cannot have intended to prohibit such fraudulent practices if they failed but not if they succeeded. The language of the statute and rule does not require such a bizarre result. The statute and rule are not confined in terms to consummated purchases or sales. They have often been applied where, as here, "plaintiffs alleged that they had sought to enter a securities transaction as purchasers or sellers, but that the transaction was aborted as a result of the fraud of the defendants." *Mount Clemens Industries, Inc. v. Bell*, 464 F.2d 339, 345 (9th Cir. 1972), citing *Opper v. Hancock Securities Corp.*, 367 F.2d 157 (2d Cir.), *affirming* 250 F. Supp. 668 (S.D.N.Y. 1966); *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715 (S.D.N.Y. 1968); *Goodman v. Hentz & Co.*, 265 F. Supp. 440 (N.D. Ill. 1967); and

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[8] Affiliated Ute Citizens v. United States, 406 U.S. 128, 151, 153 (1972); Superintendent of Insurance v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971); Teherepnin v. Knight, 389 U.S. 332, 336 (1967); Herpich v. Wallace, 430 F.2d 792, 801, 805-06 (5th Cir. 1970); Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir. 1970); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 851-52, 858 (2d Cir. 1968).

[9] *See, e.g.*, Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973); Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969).

Stockwell v. Reynolds & Co., 252 F. Supp. 215 (S.D.N.Y. 1965). *See also Walling v. Beverly Enterprises,* . . . F.2d . . . (9th Cir. April 9, 1973).

It can hardly be doubted, therefore, that the Securities and Exchange Commission, or a private person having a sufficient interest,[10] could have obtained prophylactic injunctive relief against the defendants in a timely suit.

Thus the question is not whether the complaint alleges a violation of the statute and rule, but rather whether appellant is barred from suing for damages because it succumbed to the fraud and did not purchase the offered stock.

Like the provisions of the statute and rule relating to coverage,[11] the *Birnbaum* "purchaser-seller" standing requirement is to be construed to accomplish Congress' purpose. *Herpich v. Wallace,* 430 F.2d 792, 806-07 (5th Cir. 1970), and cases there cited. If this were the sole consideration, standing would be allowed to any person whose investment decision was affected by fraud, whether the fraud caused him to buy or prevented him from doing so. In either case the fraud would frustrate Congress' purpose, as we have said; and, in either case, allowing the private remedy would serve to vindicate that purpose.[12]

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[10]Private parties may maintain an action to enjoin anticipated or continuing violations of § 10(b) and Rule 10b-5 though they could not sue for damages. *See* Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir. 1970); Britt v. Cyril Bath Co., 417 F.2d 433, 436 (6th Cir. 1969); Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 546 (2d Cir. 1967).

[11]Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); Superintendent of Insurance v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971); SEC v. National Sec. Inc., 393 U.S. 453, 466-67 (1969). See also Kern County Land Co. v. Occidental Petroleum Corp., . . . U.S. . . . , . . . (1973).

[12]*See, e.g.,* Note, *The Purchaser-Seller Requirement of Rule 10b-5 Reevaluated,* 44 U.Colo.L.Rev. 151, 154-55 (1972); Boone & McGowan, *Standing to Sue under SEC Rule 10b-5,* 49 Texas L. Rev. 617, 631, 647 (1971); Ruder, *Current Developments in the Federal Law of Corporate Fiduciary Relations-Standing to Sue under Rule 10b-5,* 26 Bus.Law. 1289, 1296 (1971); Whitaker,

The standing requirement rests in part upon other considerations, however.[13]

Cases allowing private suits for injunctive relief make it clear that the "purchaser-seller" prerequisite to standing to sue for damages rests largely on the assumption that if plaintiff does not allege that he purchased or sold the stock involved in the fraud it is evident at the outset that his claim must fail "both on proof of loss and the casual connection with the alleged violation of the Rule." *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 547 (2d Cir. 1967). *See also Britt v. Cyril Bath Co.*, 417 F.2d 433, 435-36 (6th Cir. 1969); *cf. Rekant v. Desser*, 425 F.2d 872, 881 (5th Cir. 1970); Boone & McGowan, *Standing to Sue under SEC Rule 10b-5*, 49 Texas L. Rev. 617, 646 (1971); Kellogg, *The Inability to Obtain Analytical Precision Where Standing to Sue under Rule 10b-5, Is Involved*, 20 Buffalo L. Rev. 93, 114-16 (1970).

This assumption is usually justified. Ordinarily there will be little proof (other than the non-purchaser's own opinion, after the loss) that the non-purchaser would in

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The Birnbaum Doctrine: An Assessment, 23 Ala. L.Rev. 543, 571 (1971); Note, *Inroads on the Necessity for a Consummated Purchase or Sale under Rule 10b-5*, 1969 Duke L.J. 349, 362-63 (1969).

[13]A suggestion that additional considerations may exist that give different meanings to "purchase" and "sale" as these words are used to define coverage in the statute and rule, and as they are employed in connection with the *Birnbaum* "purchaser-seller" doctrine of standing, appears in SEC v. National Sec., Inc., 393 U.S. 453 (1969). The Court stated that in defining "purchase" and "sale" as these terms are used in the statute and rule to determine coverage, the question to be asked is "whether [the] alleged conduct is the type of fraudulent behavior which was meant to be forbidden by the statute and the rule" (466-67). In a footnote at this point (467 n.9) the Court added:

> "The case presents none of the complications which may arise in determining who, if anyone, may bring private actions under § 10(b) and Rule 10b-5. This is a suit brought by the Commission; the terms 'purchase' and 'sale' are relevant only to the question of statutory coverage. Therefore there are no 'standing' problems lurking in the case." (Citations omitted.)

fact have purchased but for the fraud, and, if so, how much, when, or at what price; also, generally, the potential number of non-purchasers will be without definable limit. But this is not invariably true.

As we noted in *Mount Clemens Industries, Inc. v. Bell, supra,* a "common link" among many of the cases allowing non-purchasers or non-sellers to sue for damages under the statute and rule is "the existence of a contractual relationship between the parties." 464 F.2d at 345. Such contracts often furnish objective evidence of the reality of a plaintiff's intention to purchase or sell but for the fraud, and thus of causation. They may also fix the price, quantity, and time of sale, thus making it possible to calculate damages. And the existence of such contracts permits a reasonable circumscription of a defendant's potential liability by identifying from among the limitless number of possible non-purchasers those few that the defendant chose to deal with himself. *See Commerce Reporting Co. v. Puretec, Inc., supra,* 290 F. Supp. at 719.

Under the allegations of this complaint, the consent decree involved here served as the functional equivalent of the contractual relationship referred to in *Mount Clemens.* According to the complaint, the consent decree required defendant-appellees to offer particular securities to a specific, identifiable group of non-stockholding retail users of Blue Chip Stamps, including plaintiff-appellant, and plaintiff-appellant had a right to buy those securities at a fixed price and in a fixed amount.[14] The

[14]As defendant-appellees point out, plaintiff-appellant could not have directly enforced the decree. *See* Dahl, Inc. v. Roy Cooper Co., 448 F.2d 17, 20 (9th Cir. 1971). Indeed, the district court dismissed a claim based upon the theory that plaintiff-appellant's damage arose out of a violation of the consent decree, and that ruling was not appealed.

The rule referred to does not bar the claim before us, however. This claim rests upon the theory that plaintiff-appellant was damaged by a violation of the Securities Exchange Act of 1934 and Rule 10b-5 prohibiting fraud in connection with the purchase

complaint alleges an objective measure of the amount of loss, based on subsequent sales by defendants. As to causation, the complaint alleges that the consent decree offer was intended to be and was a bargain; that units of securities having a market value of $315 were to be offered to plaintiff-appellant for $101 — a difference so great as to provide, prima facie, an objective basis for a factual inference that users properly informed rather than misled would have accepted the offer.[15] It is also alleged that 60 per cent of those non-stockholding users who did purchase the units offered them had information as to value not made available by defendant-appellees in the prospectus.

The facts foreshadowed by plaintiff-appellant's allegations may not be forthcoming, or the suggested inferences may be shown to be untenable. If such deficiencies become apparent in pretrial proceedings, they will justify judgment short of trial. *Walling v. Beverly Enterprises, supra,* ... F.2d at .... We hold only that dismissal on the face of the complaint was premature.

Reversed and remanded for further proceedings.

HUFSTEDLER, Circuit Judge, dissenting:

The majority confers standing to bring private damage actions under section 10(b) and Rule 10b-5 upon persons who neither bought nor sold securities and who never contracted with anyone to do so. I cannot reconcile this result with existing authority in our circuit and elsewhere

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or sale of securities. The fact that the securities transaction that is the subject matter of the claim was mandated by the consent decree does not immunize defendant-appellees from the statutes and rules regulating securities transactions. Plaintiff-appellant relies upon a breach of a duty imposed by these statutory anti-fraud provisions, not upon a breach of a duty imposed by the consent decree.

[15]An informed decision by plaintiff-appellant to purchase these shares could not have been thwarted by the intervention of an earlier or higher bidder, as in Mount Clemens Industries, Inc. v. Bell, 464 F.2d 339, 346 n. 11 (1972).

or with the legislative scheme of which the section and the rule are a part. The majority's justification for the result is that these nonpurchasing appellants, as members of a class benefited by a consent divestiture decree in an action to which they were not parties, had a special status that was "functionally equivalent" to the status of an investor who had a contract to buy or to sell securities. I perceive no analogy between the two and no sound reason to create a fiction to expand the reach of section 10(b) damage actions.

The result reached by the majority is inconsistent with the holding and reasoning of this court's recent decision in *Mount Clemens Industries, Inc. v. Bell* (9th Cir. 1972) 464 F.2d 339. *Mount Clemens* held that the purchaser-seller rule governs standing to bring section 10(b) damage actions in the courts of this circuit. The court then concluded that the noncontractual status of the *Mount Clemens* nonbuyer was fatal to the maintenance of his section 10(b) claim. Similarly, the noncontractual status of the nonbuyer appellants herein should be held to bar their suit.[1]

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[1]Unless some relevant distinction between the nonpurchasers in this case and the nonpurchasers in *Mount Clemens* can be asserted, appellants herein must, on authority of *Mount Clemens*, be denied standing. To be significant, the distinction must be one which would have made a difference in outcome under the reasoning of *Mount Clemens*.

The majority opinion explicitly suggests only one distinguishing feature between the two cases: "An informed decision by plaintiff-appellant to purchase these shares could not have been thwarted by the intervention of an earlier or higher bidder, as in Mount Clemens . . . ." This distinction, however, is irrelevant.

The *Mount Clemens* court made it clear that the difficulty that plaintiffs therein would have had in proving that they could have purchased the securities in question was not of governing significance in that case: "While we agree with the District Court that the claim of the appellants is highly speculative, that circumstance alone could not necessarily deprive them of the opportunity to prove a set of facts entitling them to relief." 464 F.2d 346 n.11. The court then went on to indicate the factor that was of governing significance: "The lack of an agreement, however, does distinguish the present case from those decisions which permit

The majority, however, attempts to bring appellants within the class of protected investors by saying that the consent decree is the "functional equivalent of the contractual relationship referred to in *Mount Clemens.*" The majority means that appellants' status under the consent decree is analogous to that of purchasers or sellers whose contracts to buy or to sell aborted because of deceptive practices forbidden by section 10(b) and who were given standing to sue in cases that were cited and distinguished in *Mount Clemens.*

The functions of a contract and of the consent decree are, however, not equivalent. A contract to purchase or to sell a security is the equivalent of a purchase or a sale because the statute by definition makes them equivalent.[2] As *Mount Clemens* explained, the unifying link among the cases granting standing to persons who did not buy or sell "is the existence of a contractual relationship between the parties which elevated the plaintiff to the status of statutory purchaser or seller." (464 F.2d at 345.) A consent divestiture decree cannot function similarly because it is not a "contract" within the meaning of the statute and because no statutory provision equates "purchase"

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aborted purchasers and sellers to maintain an action for damages." *Id.*

The distinction through which the majority in this case seeks to avoid the result in *Mount Clemens,* therefore, is irrelevant, for even if the claim of the plaintiffs in *Mount Clemens* had been less speculative than the appellants' claim in this case, the result in *Mount Clemens* would have been the same. Because plaintiffs therein would nonetheless have been neither actual buyers nor contractual "purchasers", they would have been denied standing. Similarly, if the outcome in this case is to be in accord with the reasoning in *Mount Clemens,* appellants must be denied standing because appellants in this case neither actually acquired shares nor entered into contracts for their acquisition.

[2]Securities Exchange Act of 1934, § 3(a), 15 U.S.C. 78c(a):

". . . .

"(13) The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire.

"(14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

and "offer pursuant to a consent decree." The essential statutory link between the appellants and "purchasers" is missing.

The gap cannot be filled by saying, as does the majority, that a contract and the consent decree render causation and damages equally provable. Assuming that this similarity exists, it is nonetheless irrelevant. The court in *Mount Clemens* concluded that the speculativeness of a cause of action was not a ground for denying standing. (464 F.2d 346 n.11.) If speculativeness will not impair standing, a want of speculativeness cannot support standing. The ability of a plaintiff to prove causation and damages is relevant to the disposition of the merits, not to a determination of whether or not a certain plaintiff is properly before the court.

Furthermore, the appellants' ability to prove causation and damages cannot be likened to that of parties who have contracted to buy or sell. Their situations are dissimilar because a contract creates legal rights between the parties. Appellants had no duties and no rights created by the consent decree. The decree could not have been enforced against them, and they could not have enforced it, even if the parties to the action resulting in the decree had intended to benefit them specifically. *(E.g., Buckeye Co. v. Hocking Valley Co.* (1925) 269 U.S. 42; *United States v. ASCAP* (2d Cir. 1965) 341 F.2d 1003; *Control Data Corp. v. IBM Corp.* (D. Minn. 1969) 306 F. Supp. 839, *aff'd sub nom. Data Processing Financial & General Corp. v. IBM Corp.* (8th Cir. 1970) 430 F.2d 1277. *See Dahl, Inc. v. Roy Cooper Co.* (9th Cir. 1971) 448 F.2d 17, 20.[3] Because the consent decree creates no rights or

[3]A persuasive rationale for refusing to accord nonparties standing to enforce a consent decree is that the potential exposure to litigation and to liability that a contrary rule would engender would seriously impair the settlement of litigation. The public

duties in appellants, their commitment and ability to purchase the offered securities are far less definite than in a case in which a contract binds the parties. This want of definiteness renders appellants far less able to prove causation and damages than those who have contracted to buy securities and negates the "functional equivalence" that is the basis for the majority's grant of standing.

The foregoing analysis suggests that the majority does not succeed in bringing appellants within the ambit of the standing rule established in *Mount Clemens;* indeed, it does not really attempt to do so. The "functional equivalent" language masks the majority opinion's real purport, which is the creation of an exception to the purchaser-seller rule.[4] The opinion attempts to justify the

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interest in obtaining consent decrees outweighs the interest of the nonparty litigants in obtaining direct vindication of their private interests. Control Data Corp. v. IBM Corp. (D. Minn. 1969) 306 F. Supp. 839, 846. If administration of the antitrust laws would be ill served by allowing direct enforcement of consent decrees by third parties, it is difficult to understand how it would be better served by the creation of "rights", like that created by the majority opinion, that permit indirect enforcement of the decrees.

[4]The purchaser-seller rule has heretofore been understood to dictate that if a plaintiff in a section 10(b) private damage action is neither a purchaser nor a seller, he does not have standing to sue. To justify its conclusion that appellants have standing, therefore, the majority either must conclude that appellants are purchasers or sellers or must seek to modify the previously established meaning of the purchaser-seller requirement. The former conclusion cannot be sustained. The majority opinion, therefore, must be viewed as arguing for the latter conclusion.

The majority in essence establishes a second basis upon which to claim standing. Under the logic of the majority opinion, a plaintiff may bring suit if either he is a purchaser or seller or he is able to prove causation and damages. The purchaser-seller rule ceases to be operative in all cases; its applicability becomes conditional upon the plaintiff's inability to prove his cause of action.

The majority apparently believes that this is no departure from prior precedent, for it writes of "the cases allowing non-purchasers

exception by (1) implying that the purchaser-seller rule is grounded solely on a policy of denying standing where either causation or damages is dubious,[5] and (2) arguing that appellants should have standing because they could prove both elements. Neither proposition withstands scrutiny.

Although the purchaser-seller rule is occasionally buttressed by observations about the difficulties of proof that would accompany an abandonment of the rule, no authority purports to say that the potential for proving causation and damages is the essence of the rule. On the contrary, a person who is either a purchaser or seller and who alleges deception, causation, and damages can bring the action even if his ability to prove his case is nil. (*Cf. Mount Clemens Industries, Inc. v. Bell*, 464 F.2d 339, 346 n.11.) He may promptly lose on a motion for summary judgment, but his action cannot be dismissed for lack of standing. The majority opinion's effort to find sustenance for its view of the purpose of the purchaser-seller requirement in suits seeking only injunctive relief is

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or non-sellers to sue for damages under the statute and rule." No cases allowing such plaintiffs to sue are cited. Concededly, the majority cites several cases in which the strict purchaser-seller rule was relaxed somewhat. The relaxation that those cases countenance, however, is of a different sort altogether than that which the majority proposes. The majority proposes to uncouple the standing requirement from the purchaser-seller rule. The "forced seller" and "aborted purchaser-seller" cases to which the majority refers suggest only that the words "purchaser" and "seller" be liberally defined. They do not suggest that the words become altogether irrelevant and the rule of which they are a part become inoperative in certain contexts.

[5]If the majority were to fail to assert that this policy is the sole basis for the purchaser-seller rule, the logic of the opinion would fail. Even though some policies underlying the standing requirement were satisfied in a given case, if there were also other purposes to be met, standing would not properly be granted unless the majority were to show that the other policies also were not ill served by allowing appellants to sue.

unavailing. The purchaser-seller rule has only peripheral relationship to suits for an injunction.[6] A rule that no one could obtain preventive relief who could not prove that the fraud had already been consummated would be quixotic. Moreover, expansion of standing to bring suits for injunctive relief does not entail the risk of strike suits or of exposure to imponderable liability that expanded standing in damage actions threatens.

The assertion that appellants are peculiarly able to prove causation and damages and thus are separable from all other nonbuyers is also faulty. The quantity of shares offered, the price, and the time of sale are generally fixed in a securities offering. These factors, therefore, do not distinguish the offer to appellants from an offer of the same securities to the general public. Although the majority opinion says that the appellants' expectations are "rights," they are not legally cognizable rights. If the offer were withdrawn or the decree not complied with, appellants could not complain. The susceptibility of appellants' expectations to being so frustrated renders appellants' damages as difficult to prove as those of a plaintiff whose acceptance of an offer is "thwarted by the intervention of an earlier or higher bidder." Nor is it the case that causation is more easily proven by appellants than by a nonpurchasing public offeree. The majority opinion states, "ordinarily there will be little proof (other than the non-purchaser's own opinion, after the loss) that the non-purchaser would in fact have purchased but for the fraud . . ." The majority's position is reasonable, but irrelevant. One who has the opportunity

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[6]Of the three cases cited by the majority, none explicitly discussed the purchaser-seller requirement, and two involved plaintiffs who were in fact purchasers or sellers. Britt v. Cyril Bath Co. (6th Cir. 1969) 417 F.2d 433, 435. *Compare* Rekant v. Desser (5th Cir. 1970) 425 F.2d 872, 876-79 *with id.* 879-82.

to purchase securities may let the opportunity pass for want of ability to take it, for failure to notice the opportunity, or for misjudgment of the market. These considerations apply as strongly to appellants' case as they do to the case of public offerees. Appellants were as free to decline the bargain for the same reasons as any other nonbuyers. Appellants are in no better position than the public offerees to claim that if they had known the truth, they would have snapped up the bargain. The argument that a person not only adequately alleges damages, but also prima facie proves causation by stating a marked disparity between the value of the security and the offering price is startling. Any nonbuyer or nonseller could easily leap the causation hurdle if that proposition were true.

Appellants are therefore in the same legal position as were the nonbuying members of the general public to whom the same securities were subsequently made available by the consent decree and who, as appellants concede, have no standing to bring a section 10(b) damage action. Appellants cannot explain why their own situation is essentially different from other nonbuyers, except that they are a more discrete group than the general public and their disappointment can be assuaged for no more than $21,000,000, rather than many times that amount. Absent such a difference, the exception to the purchaser-seller rule that the majority seeks to establish is unjustifiable.

At the heart of the majority's inability to justify its exception to the purchaser-seller rule is what I believe to be a basic misunderstanding of the role of a standing requirement in the context of securities litigation. The majority apparently believes that any plaintiff who can credibly allege the substantive elements of a cause of

action should be granted standing. However, even if litigants can allege and even prove all of the elements of a section 10(b) damage claim, they nonetheless may lack standing. The standing doctrine is not designed to thwart actions by persons who have not suffered any injury from a wrong. It is a means of foreclosing actions by persons who have been hurt by wrongs, but who, for reasons of legislative, judicial, or social policy, are outside of the class of persons who are given a particular kind of remedy for the injury.[7] A federal standing requirement insures that litigants are sufficiently adverse to satisfy the case or controversy requisite of Article III of the Constitution, and it confines the persons who may bring suit to those whom Congress intended to provide the remedy invoked in a particular controversy. Appellants do not have standing because they are outside the class to whom Congress intended to extend the right to bring federal damage actions when it enacted section 10(b).

Congress could have preempted state law controlling deceptive practices in the marketing of these securities, and it could have given anyone injured by the practices condemned by section 10(b) a private federal damage remedy. It did neither. Instead, Congress created a scheme of private and public remedies superimposed upon state statutory and common law remedies. When confronted with a complex legislative scheme of this kind, the judiciary must be extremely careful not to upset the balances built into the scheme by lightly implying federal remedies or by diluting principles of standing. *(Cf. SEC*

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[7]The Supreme Court has described the law of standing as a "complicated specialty of federal jurisdiction, the solution of whose problems is in any event more or less determined by the specific circumstances of individual situations." United States *ex rel.* Chapman v. Federal Power Comm'n (1953) 345 U.S. 153, 156.

v. National Securities, Inc. (1969) 393 U.S. 453, 465, 467 n.9; *Holloway v. Bristol-Myers Corp.* (D.C. Cir. 1973) .... F.2d ....)

An expansive definition of the class given standing to pursue section 10(b) damage actions promises some incremental benefit in preventing deceptive practices in the marketing of securities, one of the principal purposes of the section. Expanding the class, however, entails costs as well as benefits. Incautious loosening of the purchaser-seller rule will generate federal litigation, increase the cost of marketing securities,[8] inject into securities marketing new risk factors that defy accurate assessment, expose offerors to draconian damage claims, and invite strike suits.[9] Securities markets are complex and sensitive institutions. Opening the valve, even a little, that controls the flow of section 10(b) damage actions can so far unsettle the market as to defeat, rather than to promote, the benevolent purposes of Congress in enacting

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[8]Under the majority's rule, securities traders would not only have to insure against potentially crippling damages, they would also have to bear increased compliance costs. The accuracy of a representation with regard to a security is usually judged by hindsight; if the price of the security rises substantially, prior representations may seem unduly conservative; if it falls, too optimistic. Under the purchaser-seller rule, offerors can protect themselves against unforeseen impositions of liability by acting with judicious restraint when dealing with others; they need merely avoid inaccuracies that induce others to act. If passive "investors" were also allowed to sue, such self-protective conservatism might prove suicidal, for an offeror would have to be micrometrically accurate. If securities traders are to be held responsible for lapses in such exactitude, the costs of accumulating, verifying, and presenting the necessary data would soar.

[9]The great ease with which plaintiffs can allege the requirements for the majority's standing rule and the greater difficulty that plaintiffs are going to have proving the allegations suggests that the majority's rule will allow a relatively high proportion of "bad" cases into court. The risk of strike suits is particularly high in such cases; although they are difficult to prove at trial, they are even more difficult to dispose of before trial.

the statute. *(Cf. Herpich v. Wallace* (5th Cir. 1970) 430 F.2d 792, 804.)

The purchaser-seller rule has maintained the balances built into the congressional scheme by permitting damage actions to be brought only by those persons whose active participation in the marketing transaction promises enforcement of the statute without undue risk of abuse of the litigation process and without distorting the securities market.

The majority implies that its exception to the purchaser-seller rule does no real harm because few litigants will be situated exactly as were these appellants. In my view, the majority underestimates the ingenuity of counsel, but, even if it did not, the position is jurisprudentially unsound because it does not create neutral principles of law. In drawing the standing line between deceived nonbuyers given closed-end opportunities to purchase securities pursuant to a consent decree (appellants) and deceived nonbuyers given opportunities to purchase securities on a while-they-last basis pursuant to the same consent decree (nonbuyer public investors), the majority has not supplied a rationale keyed to the statute and rule to support its conclusion.[10] Without such an underlying rationale, there are no neutral principles preventing the majority's "causation and damages" or "functional equivalence" terminology from being extended to all passive "investors".

To expand standing to nonsellers or to nonbuyers, like appellants, who have taken no affirmative action of any

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[10]The majority opinion would allow standing to sue if the misled non-buyer were one of 10 offerees who could buy no more than 10,000 shares each of a 100,000-share offering, but it would deny standing if the non-buyer were identically misled as to the same shares, but he was one of 11 offerees of 10,000 shares of the same offering to be sold on while-they-last terms. Why?

kind in reliance upon alleged deceptive statements invites litigation that has nothing to do with protecting the integrity of the marketing of securities. The passive investor could always await market developments without any risk, claiming deception caused nonbuying if the value of the securities proved more promising than the offerors' glum predictions and deception caused nonselling if a rosier prospectus was followed by a market decline. Meanwhile, securities offerors would be hard pressed to find language for prospectuses that would be sufficiently neutral to avoid potential damage suits from bystanders.

I would affirm.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MANOR DRUG STORES AND ALL OTHER USERS OF BLUE CHIP STAMPS WHO WERE ENTITLED BUT FAILED TO PURCHASE STOCK OF BLUE CHIP STAMPS, ON BEHALF OF THEMSELVES AND ALL OTHER PERSONS SIMILARLY SITUATED,

Plaintiffs-Appellants,

v.

BLUE CHIP STAMPS, a corporation, BLUE CHIP STAMP COMPANY, a merged corporation, LUCKY STORES, INC., MARKET BASKET, a corporation, PURITY STORES, INC., RALPHS GROCERY COMPANY, a corporation, SAFEWAY STORES, INC., THRIFTIMART, INC., THRIFTY DRUG STORES CO., INC., VONS GROCERY CO., a corporation, ROBERT E. ALEXANDER, DONALD A. KOEPPELL, LEONARD H. STRAUS, WILLIAM F. RAMSEY, ROBERT E. LAVERTY, RICHARD RALPHS, JOHN R. NIVEN, FRED VON DER AHE,

Defendants-Appellees.

No. 71-2223
ORDER

[Filed April 1, 1974]

Before: BROWNING, HUFSTEDLER, and CHOY, Circuit Judges

The majority opinion filed herein October 15, 1973, is modified as follows:

(1) The first sentence, [second] paragraph, slip opinion page [141],* now reads:

* The bracketed paragraph, page and line cross-references in this order have been changed in the course of printing the Appendix to correlate with the panel opinions as they are reprinted on the preceding pages.

Under the allegations of this complaint, the consent decree involved here serves the same function as did the contractual relationship referred to in *Mount Clemens.*

(2) The following new paragraph has been added prior to the concluding "disposition" line, slip opinion page [142]:

This holding does not undermine *Mount Clemens.* The allegations of the present complaint describe a highly unusual situation in which an unyielding insistence upon the existence of a contract to purchase as a prerequisite to relief would subordinate substance to form.

To meet the modifications in the language of the majority opinion, Judge Hufstedler makes the following changes in the dissenting opinion:

(1) From the first paragraph of the dissent, third sentence (slip opinion page [143]), delete the quote marks and strike the word "functionally."

(2) In the first full paragraph (slip opinion page [144]) line [3], change "is the 'functional equivalent of" to "serves the same function as did." Delete the quote mark at line 4.

(3) From the [second] paragraph (slip opinion page [144]), strike from the second line the word "equivalent" and substitute therefor the words "the same".

(4) At line [6] (slip opinion page [146]) change "'functional equivalence'" to "'same function' conclusion."

(5) From the first full paragraph (slip opinion page [146]), second sentence, change "The 'functional equiv-

alent' language" to "To state that the consent decree serves the same function as a contract".

(6) In the [second] full paragraph (slip opinion page [152]), penultimate line, change " 'functional equivalence' " to " 'same function' ".

The petition for rehearing is denied.

A majority of the court having voted to reject the suggestion for rehearing in banc, the suggestion is rejected.

Judges Koelsch, Ely, Hufstedler, Trask, and Wallace have requested that it be recited that they voted to rehear the case in banc.

No. 74-124

AUG 15
MICHAEL RODAK, JR.

In The
Supreme Court of the United States

OCTOBER TERM, 1974

BLUE CHIP STAMPS, et al.,

Petitioners,

v.

MANOR DRUG STORES, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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TOPICAL INDEX

Page

Table of Citations iii

Opinions Below 2

Jurisdiction 2

Questions Presented 2

Statutory Provisions Involved 3

STATEMENT OF THE CASE 4

1. Allegations of the Complaint 5

2. Decision of the District Court 11

3. Decision of the Court of Appeals 12

REASONS FOR GRANTING THE WRIT 14

1. The Decision Below Conflicts with Decisions In the Second, Third, Fifth, Sixth and Eighth Circuits which Deny Standing to Sue for Damages Under Rule 10b-5 to One Who Was Neither a Purchaser Nor a Seller of Securities 14

2. The Decision Below Conflicts with Decisions of This Court and the Eighth Circuit which Refuse To Permit a Non-Party to a Consent Decree to Assert in a Separate Proceeding Rights Alleged to Derive From that Consent Decree 18

3. The Decision Below Directly Conflicts with the Securities Act of 1933 and its Policy of Discouraging Unduly Optimistic Prospectuses ... 22

CONCLUSION 26

Page

Appendix A: Court of Appeals Opinions A-1

Appendix B: Order Denying Rehearing *In Banc* and Modifying Opinions B-1

Appendix C: District Court Opinion and Order Granting Defendants' Motions To Dismiss C-1

Appendix D: 15 U.S.C. § 77k D-1

Appendix E: First Amended Complaint E-1

Exhibit "A" to First Amended Complaint: Consent Decree in *United States* v. *Blue Chip Stamp Company, et al.* E-20

Exhibit "B" to First Amended Complaint: Order Approving Plan of Reorganization, ... E-33 and Plan of Reorganization of Blue Chip Stamp Company E-37

Page

TABLE OF CITATIONS

Haberman v. Murchison, 468 F.2d 1305, 1311 (2d Cir. 1972) 14

Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952) 12, 14

City National Bank of Fort Smith, Arkansas v. Vanderboom, 422 F.2d 221, 227-28 (8th Cir.), *cert. denied*, 399 U.S. 905 (1970) 15

Coffee v. Permian Corp., 434 F.2d 383, 385-86 (5th Cir. 1970), *cert. denied*, 412 U.S. 920 (1973) 16

Control Data Corp. v. International Bus. Mach. Corp., 306 F. Supp. 839 (D. Minn. 1969), *aff'd sub nom.* Data Proc. Fin. & Gen. Corp. v. International Bus. Mach. Corp., 430 F.2d 1277 (8th Cir. 1970) 20, 22

Data Proc. Fin. & Gen. Corp. v. International Bus. Mach. Corp., 430 F.2d 1277 (8th Cir. 1970), *affirming sub nom.* Control Data Corp. v. International Bus. Mach. Corp., 306 F. Supp. 839 (D. Minn. 1969) 18, 20, 21

Doman Helicopters, Inc., 41 S.E.C. 431, 439 (1963) .. 23

Eason v. General Motors Acceptance Corporation, 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 42 U.S.L.W. 3595 (April 22, 1974) 15

Erling v. Powell, 429 F.2d 795, 799-800 (8th Cir. 1970) 15

Page

Escott v. BarChris Const. Corp., 283 F. Supp. 643, 680-81 (S.D.N.Y. 1968) 22

Feit v. Leasco Data Processing Equipment Corp., 332 F. Supp. 544 (E.D.N.Y. 1971) 22, 23, 24

Greenstein v. Paul, 400 F.2d 580 (2d Cir. 1968) .. 14, 16

Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970) 16

Landy v. Federal Deposit Insurance Corp., 486 F.2d 139, 156-57 (3d Cir. 1973), *cert. denied*, 42 U.S.L.W. 3595 (April 22, 1974) 15

Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973) .. 22

Mills v. Electric Auto Lite Co., 403 F.2d 429, 434 (7th Cir. 1968), *vacated on other grounds*, 396 U.S. 375, 381 & n.4 (1970) 23

Mount Clemens Industries, Inc. v. Bell, 464 F.2d 339 (9th Cir. 1972) 12

Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 546-47 (2d Cir. 1967) 16

Rekant v. Desser, 425 F.2d 872, 879 (5th Cir. 1970) .. 15

Richland v. Crandall, 262 F. Supp. 538, 553-54 (S.D.N.Y. 1967) 23

Sargent v. Genesco, 492 F.2d 750, 763 (5th Cir. 1974) 15

Page

Simmons v. Wolfson, 428 F.2d 455, 456 (6th Cir. 1970), *cert. denied*, 400 U.S. 999 (1971) 15

Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6, 13 & n.10 (1971) 16

United States v. Armour & Co., 402 U.S. 673 (1971) 18, 19, 22

United States v. Blue Chip Stamp Company, 272 F. Supp. 432 (C.D.Cal. 1967), *aff'd sub nom.* Thrifty Shoppers Scrip Co. v. United States, 389 U.S. 580 (1968) 6

Universal Camera Corp., 19 S.E.C. 648, 652, 654-56 (1945) 23

Vanderboom v. Sexton, 422 F.2d 1233, 1243 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970) 15

Vine v. Beneficial Finance Co., 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967) 16

No. .....

In The
Supreme Court of the United States

October Term, 1974

Blue Chip Stamps, et al.,

Petitioners,

v.

Manor Drug Stores, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Pursuant to Supreme Court Rule 19, petitioners* pray for a writ of certiorari to review the decision of the United States Court of Appeals for the Ninth Circuit, which reversed a decision of the United States District Court for the Central District of California granting petitioners' motions to dismiss the first amended complaint for failure to state a claim upon which relief could be granted.

---

*Petitioners, the named defendants in this action, are Blue Chip Stamps, Blue Chip Stamp Company, Alexander's Markets, Lucky Stores, Inc., Market Basket, Purity Stores, Inc., Ralphs Grocery Company, Safeway Stores, Inc., Thriftimart, Inc., Thrifty Drug Stores Co., Inc., Vons Grocery Co., Robert E. Alexander, Donald A. Koeppel, Leonard H. Straus, William F. Ramsey, Robert E. Laverty, Richard Ralphs, John R. Niven and Fred Von der Ahe.

OPINIONS BELOW

The majority and dissenting opinions of the court of appeals are set forth in Appendix A hereto. The order of the court of appeals denying the petitions for a rehearing *in banc* and modifying the majority and dissenting opinions is set forth in Appendix B hereto. The opinions of the panel, as modified, are reported in 492 F.2d at 136. The opinion and order of the district court, reported in 339 F. Supp. at 35, is set forth in Appendix C hereto.

JURISDICTION

On October 15, 1973, a panel of the court of appeals entered its decision reversing the district court's dismissal of the first amended complaint. The matter was ordered remanded for further proceedings. On October 26, 1973, a judge of the court of appeals extended the time for petitioning for a rehearing *in banc* and ordered the mandate stayed. Timely petitions for a rehearing *in banc* were then filed. On April 1, 1974, an order was entered denying the petitions and making minor changes in the panel's opinions. Five active circuit judges noted that they would have granted a rehearing *in banc*. On June 21, 1974, Mr. Justice Douglas extended the time for filing this petition to and including August 15, 1974. This petition is, therefore, timely. 28 U.S.C. § 2101(c). The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1), and in accordance with Supreme Court Rule 19.

QUESTIONS PRESENTED

1. Can a person who has never owned, purchased or sold securities have standing under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 of

the Securities and Exchange Commission to sue for damages allegedly occasioned by his failure to purchase securities offered him?

2. Can a person who is not a party to a federal antitrust consent decree assert in a separate action rights alleged to derive from that decree?

3. Does granting standing to sue for damages under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 of the Securities and Exchange Commission to a person who allegedly declined to purchase offered securities because of an unduly pessimistic prospectus irreconcilably conflict with the purposes of the Securities Act of 1933?

STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78*j*(b), provides in pertinent part:

> "§ 78*j*. Manipulative and deceptive devices
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> ". . . .
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated by the Securities and Exchange Commission, provides as follows:

> "§ 240.10b-5 Employment of manipulative and deceptive devices.
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security."

Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, is set forth in pertinent part in Appendix D hereto.

STATEMENT OF THE CASE

Petitioners seek review of a 2-1 decision of a panel of the United States Court of Appeals for the Ninth Circuit reversing an order of the United States District Court for the Central District of California dismissing the first amended class action complaint for failure to state a claim upon which relief could be granted. The

district court had ruled that the respondent lacked standing under section 12 of the Securities Act of 1933, under section 10(b) of the Securities Exchange Act of 1934 and under rule 10b-5 of the Securities and Exchange Commission to sue for damages allegedly occasioned by its failure to purchase securities which were offered to it. The district court also ruled that respondent lacked standing to assert rights allegedly created by an antitrust consent decree to which it was not a party.

1. Allegations of the complaint.

Because the district court decided this matter on motions to dismiss, this petition assumes the truth of the averments of the first amended complaint and its supporting exhibits, which are incorporated into the complaint by reference.* The facts there set forth are as follows.**

In 1963 the government filed a civil antitrust action under the Sherman Act against Blue Chip Stamp Company and nine of its shareholder corporations. (App. E at 5.) In 1967 the action terminated with the entry of a consent decree. (App. E at 5, 20-32.) *See United*

*The first amended complaint and certain of its exhibits comprise Appendix E hereto. Other exhibits to the complaint, including two prospectuses, have not been reproduced because of their bulk. These exhibits are cited as they appear in the record on appeal.

**The exhibits to the first amended complaint include the consent decree and the reorganization plan approved by the antitrust court. In certain instances the complaint makes statements regarding the consent decree and the reorganization plan which are directly contradicted by those documents. Where these conflicts are relevant to this petition, petitioners will rely on the documents themselves since they are in the record and are incorporated into the complaint by reference. These discrepancies between the complaint's assertions and the source documents will explain some of the errors in the court of appeals' recital of the facts. *See, e.g.*, footnotes on pp. 7, 8 and 9, *infra*.

States v. Blue Chip Stamp Company, 272 F. Supp. 432 (C.D. Cal. 1967), *aff'd sub nom. Thrifty Shoppers Scrip Co. v. United States,* 389 U.S. 580 (1968). In accordance with one of the provisions of that decree, defendants submitted to the antitrust court a plan for the reorganization of Blue Chip Stamp Company. (App. E at 5-6, 37-49.) The plan was ultimately approved. (App. E at 33-36.)

The reorganization plan was designed to reduce the amount of Blue Chip stock owned by the shareholder defendants in the antitrust action to not more than 43% of that outstanding. (App. E at 35-36.) It called for the organization of a new corporation, Blue Chip Stamps ("new Blue Chip"), and the issuance by it of one share of stock to Blue Chip Stamp Company ("old Blue Chip"). (App. E at 39.) Then old Blue Chip was to be merged into new Blue Chip and a total of 621,600 shares of new Blue Chip common stock were to be issued to the stockholders of old Blue Chip. (App. E at 38, 40.) To reduce the holdings of the defendant stockholders in new Blue Chip to no more than 43% the plan provided for an offering by new Blue Chip of another 621,600 unissued shares to users of old Blue Chip's trading stamp service, and a smaller offering to Blue Chip's management. (App. E at 41-46.)

In offering the 621,600 shares to the several thousand users of old Blue Chip's trading stamp service, the number offered to each user was to be proportional to past stamp usage. (App. E at 43-44.) However, these shares were not to be sold alone: They were to be part of a package, or "unit." Each unit consisted of a $100 principal amount 6½% subordinated debenture maturing in 1978, and three shares of common stock. (App. E at 6, 37, 42; R. at 97.) The offering price of a unit was to be $101. (App. E at 6, 38.) The new Blue Chip debentures were

subordinated to various categories of existing and future legal claims and causes of action, including antitrust claims and actions, as well as certain senior indebtedness. (App. E at 42; R. at 98.)

The reorganization plan and the order of the court approving the plan both contemplated that the users might not purchase all the offered units. The plan provided that after the offering, new Blue Chip's directors would take such steps "as may be necessary" to obtain "appropriate disposition of any unsubscribed shares." (App. E at 47.) And the antitrust court's order approving the plan required that within 60 days after the election of a permanent board of directors for new Blue Chip, the company "shall present to the Court a plan for the disposition of all unsubscribed shares." (App. E at 36.) No suggestion is made in the plan or the court order approving it as to how these shares would be disposed of.*

In 1968 new Blue Chip was organized and made the offering to users contemplated by the reorganization plan. (App. E at 8-9.) More than half the units offered were sold. (App. E at 9.) Respondent and the members of the class of users it purports to represent could have purchased a portion of the units in the offering, but did not do so. (App. E at 15.)

---

*Neither the plan nor the antitrust court's order provided that "[a]ny of the 621,600 shares not purchased by the non-stockholding users were to be sold on the open market," as the court of appeals' opinion states (App. A at 4), and as the first amended complaint alleges. (App. E at 6-7.)

On the other hand, the plan did provide that the shareholder defendants could sell any of their own shares of new Blue Chip at any time. (App. E at 41.) And a large number of these shares were sold in 1969. *See* first footnote on p. 9, *infra*.

Respondent seeks recovery under essentially two theories. The first of these theories is found in counts one, two and three of the first amended complaint. These counts purport to state claims for relief under section 12 of the Securities Act of 1933, 15 U.S.C. § 77*l*, section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78*j*(b), and rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5.

In count one respondent avers that non-stockholder users of old Blue Chip's trading stamp service contended before the antitrust court that they "owned an interest in" old Blue Chip and some $20 million in profits it had accumulated and that in any decision of the government action the users' ownership of an interest in Blue Chip "should be decreed." (App. E at 7.)* These contentions allegedly "prompted" the provisions of the reorganization plan providing for an offering to users, an offering that allegedly was intended to be and was in fact a bargain designed to benefit the non-shareholder users. (App. E at 7-8.) Respondent avers that "the reasonable market value" of the units was and is "at least" $315.00, of which $75.00 represents one subordinated debenture and $80.00 represents one share of stock. Accordingly, "[t]he net bargain provided by said offering was . . . approximately $71.33 per share or $214.00 per unit." (App. E at 8.)**

---

*The non-shareholder users of old Blue Chip's stamp service were not parties to the antitrust action, and attempts by some users to intervene were denied. *United States v. Blue Chip Stamp Company*, 272 F. Supp. 432 (C.D. Cal. 1967), *aff'd sub nom. Thrifty Shoppers Scrip Co. v. United States*, 389 U.S. 580 (1968).

**It should be noted here that nowhere in the consent decree or plan of reorganization is any mention made of the asserted claim of the users to $20 million in old Blue Chip profits. Nor is there any declaration that because of those claims, a "bargain" offering of securities was to be made to users, or that the offering was, in fact, a bargain.

Respondent alleges that old Blue Chip, new Blue Chip and the stockholders and directors named in the first amended complaint desired that respondent and the members of the class it purports to represent not "exercise their rights . . . to purchase the shares to which they were entitled" under the consent decree and plan. (App. E at 10.) In furtherance of this desire, petitioners allegedly caused the preparation of a conservative — or "negative" — prospectus which disparaged the units. (App. E at 10-14.)

Specifically, respondent complains that on the second page of the prospectus used in connection with the offering of the units was set forth, under the heading "Items of Special Interest", an index and summary of items of an adverse nature which were discussed in full elsewhere in the prospectus. (App. E at 10-11; R. at 73.) When some of the petitioners sold their own shares* over a year later (without combining them with subordinated debentures), no such list was included in the new prospectus used in connection with this secondary offering. (App. E at 11-12; R. at 107-42.)** Respondent further complains that

*An examination of the complaint and the supporting documents shows the court of appeals to have erred in suggesting that the shares later sold may have been the same shares offered in 1968 as part of the units. (App. A at n.7.) The shares offered in 1969 were owned by the selling shareholders themselves, not Blue Chip Stamps, and were part of the shares originally issued to the stockholders of old Blue Chip. (App. E at 12; R. at 116-17, 124.)

**The statement in the court of appeals' opinion that the second prospectus "made no reference" to the items on this list is incorrect. (App. A at 5.) An examination of the allegations of the complaint and the factual recitations in the two prospectuses (both of which are exhibits to the complaint and incorporated therein by reference) shows that respondent alleges the *list* was absent in the second prospectus, not that the items listed went unmentioned. (App. E at 10-11; R. at 73, 107-35.)

the first prospectus called attention to the payment of some $7.9 million in settlement of legal claims and causes of action and the pendency of an additional $29 million in claims and causes of action (to which the debentures were subordinated); to the consent decree's prohibition on service on new Blue Chip's board by directors of old Blue Chip; to the court-imposed requirement that Blue Chip offer for sale one-third of its trading stamp business in California; and to the actual and possible loss of patronage by users and the fact that Blue Chip had no assurance of continued patronage. (App. E at 11.)

The respondent contends that as a result of the use of the first prospectus it and the members of the class it purports to represent were defrauded because they did not buy any units. (App. E at 14-15.) Respondent seeks to recover as damages the difference between the $101 offering price of the unsold units and the alleged present "reasonable market value" of $315. This $214 per unit totals $21.4 million in damages for respondent's alleged class. (App. E at 8-9, 15.) Also sought is the right to buy the offered but unsold units at the 1968 offering price, attorneys' fees, interest and $25 million in punitive damages. (App. E at 18-19.)

The first amended complaint's second and third counts reassert the averments of the first count. In the second count, respondent makes the additional claim that petitioners acted with actual fraudulent intent (App. E at 15-16); in the third count, respondent contends merely that the representations were made without a reasonable basis for believing them to be true. (App. E at 16-17.)

Respondent's second theory of liability is found in the fourth count, a pendent claim. It reasserts the allegations of the first count and adds the claim that respondent and the class it purports to represent were "the express

intended beneficiaries of said final consent judgment entered into between the [United States] and [the defendants in the antitrust action] . . .", that the consent judgment provided the reorganization of old Blue Chip was to be conducted in good faith, and that the petitioners' alleged misrepresentations were "a violation of the Court imposed duty of good faith and constituted a breach of said Final Consent Judgment." (App. E at 18.) Count four seeks the same relief as counts one, two and three. (App. E at 18-19.)

2. Decision of the District Court.

The district court granted petitioners' motions for an order dismissing all counts of the amended complaint for failure to state a claim upon which relief could be granted. With respect to the fourth count, the court ruled that respondent, who had not been a party to the government antitrust suit and consent decree, lacked standing to sue for breach of the terms of the antitrust court's judgment or to assert rights alleged to derive from that decree. (App. C at 3-5.)

As for the first three counts, the district court held that the statutes and rule relied upon by respondent did not give it standing to sue. Section 12 of the Securities Act of 1933 expressly limits recovery to "purchasers" of securities, something which respondent claims not to be. (App. C at 5-6.) And under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 a party has standing to sue for damages only if it has entered into a transaction having the effect of a purchase or sale of securities. Since respondent did not enter into any such transaction, it lacked standing. (App. C at 6-9.)

3. Decision of the Court of Appeals.

Respondent took an appeal to the United States Court of Appeals for the Ninth Circuit. The matter was briefed, argued and on March 2, 1972, submitted to a panel consisting of Judges Browning, Hufstedler and Choy. On March 17 the panel vacated the submission and requested that the SEC file a brief as an *amicus curiae*. The SEC submitted a brief advocating complete abandonment of the rule of *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952), that one has standing to sue for damages under rule 10b-5 only if he can be considered to have been a purchaser or seller of securities. Both petitioners and respondent filed briefs directed to the SEC's arguments and the matter was resubmitted.

On July 20, 1972, the panel requested that the parties and the SEC file memoranda on the unanimous decision by another panel of the circuit in *Mount Clemens Industries, Inc. v. Bell*, 464 F.2d 339 (9th Cir. 1972) (Chambers, Koelsch and Ely, JJ.). This decision, rendered June 28, 1972, adopted the *Birnbaum* rule in the Ninth Circuit. The parties and the SEC filed memoranda and the matter stood submitted in the fall of 1972.

The panel handed down its decision on October 15, 1973. Judge Browning, writing for himself and Judge Choy, reversed the district court and remanded the matter for further proceedings.

In finding that the respondent had standing to sue for damages, the majority reasoned as follows: The purpose of section 10(b) of the 1934 Act and rule 10b-5 is to protect the purity of stock transactions against manipulative and deceptive practices such as are alleged by respondent, and it is irrelevant to this purpose that a

purchase or sale never actually occurred. The requirement that a plaintiff in a damage action be a purchaser or seller, the majority asserted, rests on the assumption that unless a plaintiff alleges that he purchased or sold stock involved in the fraud, his chances of proving his case are too slight to allow the action to proceed. (App. A at 6-9.) This assumption is usually justified because of the lack of objective evidence regarding causation and damages. (App. A at 9.) However, the majority noted, plaintiffs who have been parties to a contract to purchase or sell securities have been granted standing to sue for damages, even though there was no consummated purchase or sale. It concluded that the consent decree served as a "functional equivalent" of a contract to purchase, reducing the speculative nature of respondent's causation and damage claims sufficiently to satisfy what the majority saw as the purpose of the purchaser-seller standing requirement. (App. A at 9-11.)

Judge Hufstedler, in dissent, said of the majority's ruling that it amounts to a rejection of the purchaser-seller rule in any case where a plaintiff can allege causation and damages (App. A at 15-18), that it cannot be reconciled with the cases denying non-parties to antitrust consent decrees standing to sue on those decrees (App. A at 13-15 & n.3), and that it makes possible damage actions by non-participants in the securities markets who risk nothing and simply watch from the sidelines. (App. A at 20-22.)

On November 5, 1973, a rehearing *in banc* was requested; on April 1, 1974, it was denied. Judges Koelsch, Ely, Hufstedler, Trask and Wallace noted their votes to rehear the case *in banc*. The order denying the rehearing also made minor changes in the opinions of both the panel majority and the dissenter. (App. B.)

REASONS FOR GRANTING THE WRIT

The decision of the panel majority warrants review by this Court.

1. The Decision Below Conflicts with Decisions In the Second, Third, Fifth, Sixth and Eighth Circuits which Deny Standing to Sue for Damages Under Rule 10b-5 to One Who Was Neither a Purchaser Nor a Seller of Securities.

The rule of *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952), that only purchasers or sellers of securities have standing to sue under section 10(b) and rule 10b-5 for damages, has been consistently followed over the years. The Second Circuit has repeatedly reaffirmed *Birnbaum*. In *Greenstein v. Paul*, 400 F.2d 580 (2d Cir. 1968), the court again noted that a non-selling shareholder did not have standing to sue for damages under rule 10b-5:

> "It has long been the rule in this circuit that to maintain an action under § 10(b) of the Act and Rule 10b-5 of the Securities and Exchange Commission the plaintiff must have been a seller of the stock involved. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (C.A. 2, 1952), *cert. denied*, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952). Although criticized, *Entel v. Allen*, 270 F. Supp. 60, 70 (S.D.N.Y. 1967), it is still the rule at least insofar as actions for damages are concerned." 400 F.2d 580, 581.

Accord, Haberman v. Murchison, 468 F.2d 1305, 1311 (2d Cir. 1972).

The Third, Fifth, Sixth and Eighth Circuits have all joined the Second Circuit in refusing standing to sue for damages to one such as respondent who is not a pur-

chaser or seller of securities. *E.g., Landy v. Federal Deposit Insurance Corp.*, 486 F.2d 139, 156-57 (3d Cir. 1973), *cert. denied*, 42 U.S.L.W. 3595 (April 22, 1974); *Rekant v. Desser*, 425 F.2d 872, 879 (5th Cir. 1970); *Sargent v. Genesco*, 492 F.2d 750, 763 (5th Cir. 1974); *Simmons v. Wolfson*, 428 F.2d 455, 456 (6th Cir. 1970), *cert. denied*, 400 U.S. 999 (1971); *City National Bank of Fort Smith, Arkansas v. Vanderboom*, 422 F.2d 221, 227-28 (8th Cir.), *cert. denied*, 399 U.S. 905 (1970); *Vanderboom v. Sexton*, 422 F.2d 1233, 1243 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970); and *Erling v. Powell*, 429 F.2d 795, 799-800 (8th Cir. 1970).

The Seventh Circuit has said it has permitted a non-purchasing, non-selling investor to sue for damages under rule 10b-5. *Eason v. General Motors Acceptance Corporation*, 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 42 U.S.L.W. 3595 (April 22, 1974) (Burger, C.J., Douglas and White, JJ., dissenting from denial of certiorari; Powell, J., not participating).* But until the ruling below, no circuit had even suggested granting standing to sue for damages to non-purchasing, non-selling, non-investing offerees.

*In *Eason* the plaintiffs were investors who held shares in the defrauded corporation and who had executed personal guarantees of notes in connection with the allegedly fraudulent transaction that resulted in the issuance of 7,000 shares of their corporation's stock to defendants. They asserted their 10b-5 claims in response to a suit by a defendant on the guarantees. On these facts it could be argued that the fraud was intimately connected with the transfer of securities. There is, therefore, substantial question as to whether *Eason* is actually inconsistent with the line of authority requiring a plaintiff to be classifiable as a purchaser or seller of securities.

But even if the plaintiffs in *Eason* were in fact not purchasers or sellers, that decision is still at odds with the decision below. For the *Eason* court said it was allowing standing to investors because they were protected by the rule and the section; it nowhere suggested that non-investors were within the protection of the rule and section, or that they should be granted standing.

The long standing purchaser-seller limitation retains its vitality. *See Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 & n.10 (1971). In injunction actions non-purchasing, non-selling stockholders have been allowed standing to sue for preventive relief from fraud which, if successful, would harm a selling shareholder. But in so ruling the courts have drawn a clear distinction between actions seeking injunctive relief and actions seeking damages. *See Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 546-47 (2d Cir. 1967); *Greenstein v. Paul*, 400 F.2d 580, 581 (2d Cir. 1968); *Kahan v. Rosenstiel*, 424 F.2d 161, 173 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970). The "forced seller" cases also show the continuing strength of the purchaser-seller limitation while adapting it to particular circumstances. *See, e.g., Vine v. Beneficial Finance Co.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967); *Coffee v. Permian Corp.*, 434 F.2d 383, 385-86 (5th Cir. 1970), *cert. denied*, 412 U.S. 920 (1973).

The decision of the Ninth Circuit here stands alone as abrogating the purchaser-seller rule and enunciating a rule that permits any plaintiff to bring a damage action under 10b-5 if he can allege causation and damages with any plausibility.

The panel majority attempted to create the illusion that its decision was no departure from existing purchaser-seller authority by reasoning that persons who are parties to enforceable contracts to buy or sell securities have been permitted standing to sue for damages because those contracts eliminate the speculativeness of their damage claims; since the consent decree here is the "functional equivalent" of a contract to purchase or sell, the majority reasoned, that line of authority supports respondent's standing. (App. A at 9-10.)

The majority's reasoning is defective. The cases relied upon fail to provide the sought after support.* And the speculative nature of respondent's claim is not reduced sufficiently by the fact of the consent decree to set respondent apart from any other person who declined to purchase securities in the course of an offering made to an identifiable group of persons at a fixed price. Any such non-purchasing offeree could, like respondent, state a claim that could not be summarily disposed of by alleging that it would have bought the securities but for the defendant's actions, and that the securities were worth more than the asking price. (*See* App. A at 9-10.) To grant standing to such a plaintiff is clearly to throw over the purchase-seller limitation and invite the filing of actions on behalf of large classes of non-purchasing, non-selling, non-investors.

Under the decision of the panel one would have to have purchased or sold securities to obtain standing to sue for damages *only* when he was not creative enough to allege facts that would give his claims the appearance of non-speculativeness. This ruling is erroneous and conflicts directly with every other court that has considered the issue.

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*The cases involving contracts to buy or sell securities relied upon by the majority, such as *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715 (S.D.N.Y. 1968), permitted plaintiffs standing to sue because the 1934 Act defines the terms "purchase" or "sale" as including *a contract* to purchase or sell securities, not because the contracts were thought to limit the speculative character of the plaintiffs' claims.

As Judge Hufstedler notes, considerations other than barring speculative claims underlie the purchaser-seller standing requirement, considerations the majority wholly ignores. (App. A at 18-21.)

2. The Decision Below Conflicts with Decisions of This Court and the Eighth Circuit which Refuse To Permit a Non-Party to a Consent Decree to Assert In a Separate Proceeding Rights Alleged to Derive From that Consent Decree.

If this case is to be read as consistent with the purchaser-seller line of authority, and respondent is to be distinguished from any other disappointed plaintiff complaining of his failure to buy offered securities, that distinction can only be that the consent decree conferred upon respondent special rights, rights that are analogous to enforceable contractual rights and qualify it for standing under the purchaser-seller rule. But to the extent the majority accepted the respondent's averments that the consent decree was intended to confer on the non-shareholder users of Blue Chip's trading stamp service rights that can be indirectly enforced through a securities act suit, then the decision below is in conflict with this Court's decision in *United States v. Armour & Co.*, 402 U.S. 673 (1971), and with the Eighth Circuit's decision in *Data Proc. Fin. & Gen. Corp. v. International Bus. Mach. Corp.*, 430 F.2d 1277 (8th Cir. 1970), *affirming sub nom. Control Data Corp. v. International Bus. Mach. Corp.*, 306 F. Supp. 839 (D. Minn. 1969).

The majority's opinion relies heavily upon the first amended complaint's averments that under the consent decree the respondent had a "right" to purchase the securities offered, and that the court and government "intended" the offering to be a "bargain" to compensate the non-shareholder users for their "interest" in old Blue Chip's retained profits. And all this was supposedly "prompted" by the arguments presented to the antitrust court by users who were not parties to the government case. (App. A at 3-4.) By referring to these averments

the court suggests that the respondent and its purported class were intended to be the recipients of very direct and substantial benefits under the decree, benefits to which they had a right.

The consent decree, however, does not mention the offering, and the plan of reorganization provides only that the units are to be offered to the users. Neither the decree nor the plan mentions the asserted claims of the users to $20 million in old Blue Chip profits, or states that the offering is intended to be or will in fact be a "bargain" offering.

In *United States v. Armour & Co.*, 402 U.S. 673 (1971), the government sought certain relief under the 1920 meatpackers' consent decree on grounds that it was necessary to effectuate the decree's purposes. In affirming a denial of the requested relief the Court held that consent decrees, unlike decrees entered after full litigation through judgment, cannot be said to have any purposes. Rather, the parties to the decree have purposes which are generally opposed to each other.

> "[T]he resultant decree embodies as much of those opposing purposes as the respective parties have the bargaining power and skill to achieve. For these reasons, the scope of a consent decree must be discerned within its four corners, and not by reference to what might satisfy the purposes of one of the parties to it. Because the defendant has, by the decree, waived his right to litigate the issues raised, a right guaranteed to him by the Due Process Clause, the conditions upon which he has given that waiver must be respected, and the instrument must be construed as it is written . . . ." 402 U.S. at 681-82 (footnote omitted).

Accordingly, the court of appeals should have ignored the allegations of the complaint which refer to the purposes of the decree and the intentions of the parties and non-parties, since they find no support in the text of either decree or plan. In failing to so do the court brought itself into direct conflict with *Armour*.

If this case is distinguished from any other brought by a non-purchasing, non-selling, non-investor because of respondent's alleged rights under the decree, then it is also in conflict with *Data Proc. Fin. & Gen. Corp. v. International Bus. Mach. Corp.*, 430 F.2d 1277 (8th Cir. 1970), *affirming sub nom. Control Data Corp. v. International Bus. Mach. Corp.*, 306 F. Supp. 839 (D. Minn. 1969). In this Eighth Circuit decision, which is not mentioned in the majority's opinion, claims were made by non-parties to earlier consent decrees that they were the intended beneficiaries of those decrees and had a right to relief if the defendant thwarted their realizing those benefits. The district court ordered the claims stricken from the pleadings.

The court reasoned that the Attorney General is the representative of the public in government antitrust suits, and under established authority only parties can derive rights from or sue to enforce a consent decree terminating a government action. The pro-consent decree policies underlying this rule also require that non-parties to decrees, even if direct and intended beneficiaries, be denied standing to do, through a separate suit bottomed upon the obligations imposed by the decree, what they could not do directly — enforce the decree. 306 F. Supp. at 845-48. The actions were ordered to proceed as though the decrees had never been entered.* The court of appeals

*The court in *Control Data* suggested two avenues by which respondent here might have presented its alleged grievances regarding the prospectus and the offering.

(Footnote continued on following page.)

affirmed, having approved the district court's reasoning. 430 F.2d at 1278.

The decision of the majority below is potentially destructive of the Department of Justice's program for terminating most government antitrust actions *via* consent decree. If antitrust defendants cannot be assured that their liabilities under a negotiated consent decree will be limited to those agreed to by the parties to the action, then they will be much more reluctant to give up their right to litigate.

Moreover, defendants in hundreds of government actions have entered consent decrees over the years with the understanding that their liabilities were carefully circumscribed. The decision below would work a retroactive revision of those decrees by allowing non-parties to

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(Footnote continued from preceding page.)

First, the respondent might have attempted to persuade the Antitrust Division of the Department of Justice that the decree had been frustrated by petitioners' alleged misrepresentations, and that corrective action should be sought by the government from the antitrust court. (The decree provides for a reservation of jurisdiction by the antitrust court to entertain applications by "any of the parties" for enforcement or modification of the decree, or to punish violations of it.) Apparently the respondent chose not to attempt to persuade the government of the correctness of its views regarding the decree. Or perhaps the attempt was made, but was unsuccessful.

Alternatively, respondent might have applied for leave to intervene in the antitrust case as a party. Instead, respondent chose to commence this class action seeking damages under the federal securities laws, and a state court class action raising the same claims under California law. *Manor Drug Stores, etc. v. Blue Chip Stamps, et al.*, No. C-5652 in the Superior Court, County of Los Angeles. (The state action has been in abeyance pending disposition of the federal action.)

It might also be noted that the antitrust court made no adjudication with respect to the rights of the users; any rights the users possessed before entry of the decree were unaffected by its entry, by the plan, or by the offering. Yet respondent has never made any attempt to assert its supposed "rights" to $20 million in retained old Blue Chip profits.

come forward and claim enforceable rights under them. Such a result may well deny due process to those who gave up their right to defend themselves in exchange for a negotiated decree. *See United States v. Armour & Co.*, 402 U.S. at 681-82; *Control Data Corp. v. International Bus. Mach. Corp.*, 306 F. Supp. at 846-48.

3. The Decision Below Directly Conflicts with the Securities Act of 1933 and its Policy of Discouraging Unduly Optimistic Prospectuses.

The decision of the court below presents an important question of federal law that has not been, but should be, settled by this Court. The rule established by the court below will result in those preparing prospectuses being exposed to suit by a non-purchaser under the Securities Exchange Act of 1934 if the stock issued rises in value and the prospectus appears to have been too negative, and to suit by a purchaser under the Securities Act of 1933 if the stock declines in value and the prospectus appears to have been too positive. This result upsets the balance between the 1933 and 1934 Acts maintained by the purchaser-seller rule and will produce results inconsistent with the policies of the 1933 Act.

The Securities Act of 1933 requires that all material facts, including adverse potentialities such as those which respondent complains were unduly emphasized by Blue Chip, be disclosed in a prospectus. *See, e.g., Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973) *(in banc)*; *Escott v. BarChris Const. Corp.*, 283 F. Supp. 643, 680-81 (S.D.N.Y. 1968); *Feit v. Leasco Data Processing Equipment Corp.*, 332 F. Supp. 544, 569-71 (E.D.N.Y. 1971) (collecting and analyzing the authorities). And the adverse facts cannot be merely disclosed: They must be

given an emphasis sufficient to convey their importance and the risk they portend for the investor. *See Mills v. Electric Auto Lite Co.*, 403 F.2d 429, 434 (7th Cir. 1968), *vacated on other grounds*, 396 U.S. 375, 381 & n.4 (1970); *Richland v. Crandall*, 262 F. Supp. 538, 553-54 (S.D.N.Y. 1967); *Feit v. Leasco Data Processing Equipment Corp.*, 332 F. Supp. at 564-65. The SEC has held that a failure to emphasize pertinent risk factors in a prospectus and in a registration statement constitutes a material failure to comply with the disclosure requirements of the 1933 Act. *E.g., Doman Helicopters, Inc.*, 41 S.E.C. 431, 439 (1963); *Universal Camera Corp.*, 19 S.E.C. 648, 652, 654-56 (1945). See S.E.C. Release No. 4936, *Guides for Preparation and Filing of Registration Statements*, p. 6, ¶ 6 (1968).

This requirement of disclosure of and emphasis on adverse matters comports with Congress' purpose of protecting investors from issuers "puffing" the value of their securities by minimizing the risks inherent in their purchase. *See* H.R. Rep. No. 85, 73d Cong., 1st Sess. 2, 8 (1933).

To back up this policy, Congress enacted, *inter alia*, section 11 of the 1933 Act, 15 U.S.C. § 77k.* This section permits a purchaser to sue the issuer for damages occasioned by a *decline* in the price of the purchased securities, without regard to reliance by the purchaser upon the prospectus. He need show no more than that the prospectus (which is filed with and constructively constitutes a portion of the registration statement) contains "an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make statements therein not misleading." The non-negligence of the issuer is no defense to such an action.

*Relevant portions of this statute are contained in Appendix D hereto.

§ 11(b), 15 U.S.C. § 77k(b). "Section 11 creates almost absolute liability in the issuer." *Feit v. Leasco Data Processing Equipment Corp.*, 332 F. Supp. 544, 575 (E.D.N.Y. 1971) (citing authorities). Substantially similar liability is imposed by section 11 upon directors of the issuer. "Their liability approaches that of the issuer as guarantor of the accuracy of the prospectus." 332 F. Supp. at 578.

These directives under the 1933 Act force a prospectus draftsman to disclose fully and to emphasize amply adverse contingent matters and his predictive judgment as to the impact they may have on the business in the future. By couching his descriptions and predictions in conservative and cautionary terms, he can seek to protect both the issuer and its directors from liability under section 11, and the purchaser from buying without fully appreciating the risks of the investment.

Now, in the face of the policy of the 1933 Act that adverse matters must not be understated, comes the decision of the majority below holding that one who does not purchase offered securities can sue for damages under section 10(b) of the 1934 Act and rule 10b-5 if the adverse matters appear in hindsight to have been overstated. The prospectus draftsman is confronted with an almost impossible task: (i) disclose and adequately emphasize adverse contingencies, on pain of purchasers suing to recover for a disclosure which underestimated the risks involved; and (ii) do not unduly emphasize adverse contingencies, on pain of non-purchasers suing to recover damages for a disclosure which over-estimated the risks of the investment.

The rule adopted by the court below will increase the probability that a given prospectus will be overly optimistic, or at least will give less than full emphasis to

adverse facts — an effect that flies in the face of the congressional intent underlying the 1933 Act. In the final analysis, the investing public will receive less protection against "puffing" than presently exists and issuers will have an immensely greater exposure to liability, and almost certain exposure to costly litigation. Neither exposure will be avoidable.*

The decision below should be reversed. In this area the purchaser-seller limitation serves to harmonize the 1933 and 1934 Acts and provides a buffer zone within which those preparing prospectuses can work.

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*It seems inevitable that every prospectus will contain predictive judgments which, when viewed in the bright gleam of hindsight, will appear to have been wrong. In this case the testing period was more than two years. The amended complaint was filed in January of 1971; the prospectus was dated August of 1968.

It is no answer to this conflict between the 1933 Act and the 1934 Act to argue that while the former fixes liability without fault, the latter does not. Whatever the final standard a trier of fact may apply to a given prospectus and its purposes, the fact remains that under the majority's reasoning nothing is required to state a cause of action that will survive attempts at summary disposition other than conclusory allegations that defendant had an intent to mislead, that the prospectus was too negative, and that the plaintiff did not purchase for that reason. This means that almost any non-purchasing offeree can impose on an issuer and its directors the burdens and uncertainties of litigation, and resist attempts to resolve the matter short of trial. A device more subject to abuse would be hard to imagine. And the expense of such actions will ultimately be borne by those who did purchase the offered securities.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be granted.

Respectfully submitted,

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August, 1974

Appendix A

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MANOR DRUG STORES AND ALL OTHER USERS OF BLUE CHIP STAMPS WHO WERE ENTITLED BUT FAILED TO PURCHASE STOCK OF BLUE CHIP STAMPS, ON BEHALF OF THEMSELVES AND ALL OTHER PERSONS SIMILARLY SITUATED,

Plaintiffs-Appellants,

vs.

BLUE CHIP STAMPS, a corporation, BLUE CHIP STAMP COMPANY, a merged corporation, LUCKY STORES, INC. MARKET BASKET, a corporation, PURITY STORES, INC., RALPHS GROCERY COMPANY, a corporation, SAFEWAY STORES, INC., THRIFTIMART, INC., THRIFTY DRUG STORES CO., INC., VONS GROCERY CO., a corporation, ROBERT E. ALEXANDER, DONALD A. KOEPPEL, LEONARD H. STRAUS, WILLIAM F. RAMSEY, ROBERT E. LAVERTY, RICHARD RALPHS, JOHN R. NIVEN, FRED VON DER AHE,

Defendants-Appellants.

No. 71-2223
OPINION

[October 15, 1973]

Appeal from the United States District Court
for the Central District of California

Before: BROWNING, HUFSTEDLER, and CHOY, Circuit Judges

BROWNING, Circuit Judge:

The district court dismissed appellants' complaint under section 10(b) of the Securities Exchange Act of 1934,[1] 15 U.S.C. § 78j(b), and Securities and Exchange Commission Rule 10b-5,[2] claiming damages for alleged fraud in connection with an offering of stock of appellee Blue Chip Stamps to appellant and the class it seeks to represent. The court held that because appellant and other members of the class did not purchase the stock they lacked standing to sue under the rule announced in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952).[3] We conclude that it does not appear "beyond doubt" that appellant "can prove no set of facts in sup-

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[1]Section 10(b) of the Act provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

(b) To use or employ, *in connection with the purchase or sale of any security* registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. (Emphasis added.)

[2]The Rule provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person *in connection with the purchase or sale of any security.* (Emphasis added.)

port of [its] claim that appellant "can prove no set of facts in support of [its] claim which would entitle [it] to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). We therefore reverse.

The alleged facts are as follows.[4]

In 1963 the United States filed a complaint charging Blue Chip Stamp Company, Thrifty Drug Stores Co., Inc., and eight grocery chains with conspiracy to restrain trade and monopolization in the trading stamp business in California, in violation of the Sherman Act. This litigation was settled in 1967 by entry of a consent decree. *See United States v. Blue Chip Stamp Co.*, 272 F. Supp. 432 (C.D. Calif. 1967).

The defendants in the antitrust suit, other than Blue Chip Stamp Company, were major California retail merchandisers who used Blue Chip stamps to stimulate patronage in their businesses. They owned 90 per cent of Blue Chip Stamp Company's stock.

Other retailers who used Blue Chip stamps in their business but owned no stock in Blue Chip Stamp Company (a group that includes appellant and others in the class it seeks to represent) appear [sic.] before the court in the antitrust proceeding as amicus curiae. They contended that Blue Chip Stamp Company was to have been a non-profit venture on behalf of all users of Blue Chip

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[3]This court adopted the *Birnbaum* rule in Mount Clemens Industries, Inc. v. Bell, 464 F.2d 339 (9th Cir. 1972). *See also* Lanning v. Serwold, 474 F.2d 716 (9th Cir. 1973); Walling v. Beverly Enterprises, ... F.2d ..... (9th Cir. April 9, 1973).

[4]Some minor details are drawn from material submitted by appellant to this court. They are appropriately considered as reflecting the nature of the facts that might have been established under the allegations of the complaint. *See* Herpich v. Wallace, 430 F.2d 792, 809 (5th Cir. 1970); Shell v. Hensley, 430 F.2d 819, 822 n.8 (5th Cir. 1970.)

stamps, and that they (the non-stockholding users) in fact owned an equitable interest in Blue Chip Stamp Company and in the $20,000,000 in profits it has accumulated. They asked that this interest be recognized in the decree.

These claims and contentions on behalf of the non-stockholding retail users of Blue Chip stamps "prompted the provisions" of the consent decree requiring the reorganization of Blue Chip Stamp Company. Under the reorganization plan eventually approved, Blue Chip Stamp Company was to be merged into a new company—Blue Chip Stamps. The defendant stockholder-users were to be divested of 55 percent of their interest in the enterprise. This was to be accomplished by issuing to others 55 percent of the common stock of the new company; 621,600 shares of the common stock of the new company were to be offered to the retail users of Blue Chip stamps who were not stockholders of the old company. The shares were to be offered on a pro-rata basis determined by the quantity of stamps issued to each of these non-stockholding users during a designated period. The offering was to be made in units consisting of three shares of common stock and a $100 debenture for a cash payment of $101. Any of the 621,600 shares not purchased by the non-stockholding users were to be sold on the open market.

The offer of debentures and stock to non-stockholding users was intended by the court and government to be, and was, a bargain. Each unit offered to the non-stockholding user for $101 had a reasonable market value of $315, as defendant-appellees knew.

Users who were stockholders in the old company (including the defendant-appellees in this case)[5] did not want the non-stockholding users to exercise their right to purchase stock in the new company. To accomplish their purpose they caused to be prepared and circulated a prospectus "calculated to mislead and dissuade users not knowledgeable of the true value of said shares from purchasing said shares." The prospectus repeatedly emphasized certain "Items of Special Interest" as having an adverse effect upon the value of the offered stock.[6] "Constant reference to said items was intended to, and did cause plantiffs to be misled as to the true value of said shares." When defendant-appellees offered "their own" shares to the public a year later,[7] the prospectus then issued made no reference to any of these "Items of Special Interest," although they were as relevant (or

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[5]Defendant-appellees are Thrifty Drug Stores Co., Inc., seven of the eight grocery chains that were defendants in the antitrust suit, the old Blue Chip Stamp Company, the new Blue Chip Stamp Corporation, and the members of the board of directors of the latter.

[6]One such item was the pendency of claims against the company said to "aggregate approximately $29,000,000." Defendant-appellees allegedly knew the claims "were of insignificant merit"; they were settled for less than $1,000,000.

In addition to reference to the "Items of Special Interest," the complaint alleges other misleading statements, including an estimate that 97½% of the Blue Chip stamps issued by the new company would be redeemed when historically less than 90% were redeemed. This alleged misrepresentation "resulted in an understatement of earnings on stamp sales for the year prior to the offering of Six Million Dollars ($6,000,000) or about eighty per cent (80%)."

[7]It is unclear from the complaint whether the unsold shares originally offered to non-stockholding users were eventually sold, and at what price. The complaint mentioned sales by defendants of "their own" shares, although plaintiff-appellant's brief indicates that the same shares offered to them "were offered to the general public one year later." The facts may be resolved in further proceedings.

irrelevant) on the date of the second prospectus as they had been on the date of the first.

Defendant-appellees, by these and other means, intended to and did mislead plaintiff-appellant and other user-offerees as to value of the stock. Plaintiff-appellant and others in the class it represents, relying upon these representations, "were induced and did, in fact, not accept said offer and purchase said Units," and were thereby damaged in the amount of the difference between the offering price of the units and their fair market value.

We are not satisfied that these allegations establish on their face that appellant is barred from maintaining the action by the judicially created "purchaser-seller" prerequisite to standing to sue for damages under section 10(b) and Rule 10b-5.

The complaint alleges the use of a fraudulent scheme involving untrue statements and omissions in offering securities of Blue Chip Stamps for sale.

The statute and rule were intended to protect the purity of stock transactions from just such manipulative and deceptive practices that deprive potential investors of a reasonable opportunity to make informed and intelligent investment decisions.[8] It is obviously irrelevant to this purpose that the object of the deceptive practices was to prevent purchases rather than to induce them.[9]

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[8]Affiliated Ute Citizens v. United States, 406 U.S. 128, 151, 153 (1972); Superintendent of Insurance v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967); Herpich v. Wallace, 430 F.2d 792, 801, 805-06 (5th Cir. 1970); Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir. 1970); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 851-52, 858 (2d Cir. 1968).

[9]*See, e.g.*, Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973); Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969).

And Congress and the Commission cannot have intended to prohibit such fraudulent practices if they failed but not if they succeeded. The language of the statute and rule does not require such a bizarre result. The statute and rule are not confined in terms to consummated purchases or sales. They have often been applied where, as here, "plaintiffs alleged that they had sought to enter a securities transaction as purchasers or sellers, but that the transaction was aborted as a result of the fraud of the defendants." *Mount Clemens Industries, Inc. v. Bell*, 464 F.2d 339, 345 (9th Cir. 1972), citing *Opper v. Hancock Securities Corp.*, 367 F.2d 157 (2d Cir.), *affirming* 250 F. Supp. 668 (S.D.N.Y. 1966); *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715 (S.D.N.Y. 1968); *Goodman v. Hentz & Co.*, 265 F. Supp. 440 (N.D. Ill. 1967); and *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215 (S.D.N.Y. 1965). *See also Walling v. Beverly Enterprises*, ... F.2d ..... (9th Cir. April 9, 1973).

It can hardly be doubted, therefore, that the Securities and Exchange Commission, or a private person having a sufficient interest,[10] could have obtained prophylactic injunctive relief against the defendants in a timely suit.

Thus the question is not whether the complaint alleges a violation of the statute and rule, but rather whether appellant is barred from suing for damages because it succumbed to the fraud and did not purchase the offered stock.

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[10]Private parties may maintain an action to enjoin anticipated or continuing violations of § 10(b) and Rule 10b-5 though they could not sue for damages. *See* Kahan v. Rosenstiel, 424 F.2d 161, 173 (3d Cir. 1970); Britt v. Cyril Bath Co., 417 F.2d 433, 436 (6th Cir. 1969); Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 546 (2d Cir. 1967).

Like the provisions of the statute and rule relating to coverage,[11] the *Birnbaum* "purchaser-seller" standing requirement is to be construed to accomplish Congress' purpose. *Herpich v. Wallace,* 430 F.2d 792, 806-07 (5th Cir. 1970), and cases there cited. If this were the sole consideration, standing would be allowed to any person whose investment decision was affected by fraud, whether the fraud caused him to buy or prevented him from doing so. In either case the fraud would frustrate Congress' purpose, as we have said; and, in either case, allowing the private remedy would serve to vindicate that purpose.[12]

The standing requirement rests in part upon other considerations, however.[13]

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[11]Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); Superintendent of Insurance v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971); SEC v. National Sec. Inc., 393 U.S. 453, 466-67 (1969). See also Kern County Land Co. v. Occidental Petroleum Corp., ... U.S. ...., ... (1973).

[12]*See, e.g.,* Note, *The Purchaser-Seller Requirement of Rule 10b-5 Reevaluated,* 44 U.Colo.L.Rev. 151, 154-55 (1972); Boone & McGowan, *Standing to Sue under SEC Rule 10b-5,* 49 Texas L. Rev. 617, 631, 647 (1971); Ruder, *Current Developments in the Federal Law of Corporate Fiduciary Relations-Standing to Sue under Rule 10b-5,* 26 Bus.Law. 1289, 1296 (1971); Whitaker, *The Birnbaum Doctrine: An Assessment,* 23 Ala. L.Rev. 543, 571 (1971); Note, *Inroads on the Necessity for a Consummated Purchase or Sale under Rule 10b-5,* 1969 Duke L.J. 349. 362-63 (1969).

[13]A suggestion that additional considerations may exist that give different meanings to "purchase" and "sale" as these words are used to define coverage in the statute and rule, and as they are employed in connection with the *Birnbaum* "purchaser-seller" doctrine of standing, appears in SEC v. National Sec., Inc., 393 U.S. 453 (1969). The Court stated that in defining "purchase" and "sale" as these terms are used in the statute and rule to determine coverage, the question to be asked is "whether [the] alleged conduct is the type of fraudulent behavior which was meant to be forbidden by the statute and the rule" (466-67). In a footnote at this point (467 n.9) the Court added:

Cases allowing private suits for injunctive relief make it clear that the "purchaser-seller" prerequisite to standing to sue for damages rests largely on the assumption that if plaintiff does not allege that he purchased or sold the stock involved in the fraud it is evident at the outset that his claim must fail "both on proof of loss and the causal connection with the alleged violation of the Rule." *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 547 (2d Cir. 1967). *See also Britt v. Cyril Bath Co.*, 417 F.2d 433, 435-36 (6th Cir. 1969); *cf. Rekant v. Desser*, 425 F.2d 872, 881 (5th Cir. 1970); Boone & McGowan, *Standing to Sue under SEC Rule 10b-5*, 49 Texas L. Rev. 617, 646 (1971); Kellogg, *The Inability to Obtain Analytical Precision Where Standing to Sue under Rule 10b-5 Is Involved*, 20 Buffalo L. Rev. 93, 114-16 (1970).

This assumption is usually justified. Ordinarily there will be little proof (other than the non-purchaser's own opinion, after the loss) that the non-purchaser would in fact have purchased but for the fraud, and, if so, how much, when, or at what price; also, generally, the potential number of non-purchasers will be without definable limit. But this is not invariably true.

As we noted in *Mount Clemens Industries, Inc. v. Bell, supra, a* "common link" among many of the cases allowing non-purchasers or non-sellers to sue for damages under the statute and rule is "the existence of a contractual relationship between the parties." 464 F.2d at 345. Such contracts often furnish objective evidence of the reality of a plaintiff's intention to purchase or sell but for the

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"The case presents none of the complications which may arise in determining who, if anyone, may bring private actions under § 10(b) and Rule 10b-5. This is a suit brought by the Commission; the terms 'purchase' and 'sale' are relevant only to the question of statutory coverage. Therefore there are no 'standing' problems lurking in the case." (Citations omitted.)

fraud, and thus of causation. They may also fix the price, quantity, and time of sale, thus making it possible to calculate damages. And the existence of such contracts permits a reasonable circumscription of a defendant's potential liability by identifying from among the limitless number of possible non-purchasers those few that the defendant chose to deal with himself. *See Commerce Reporting Co. v. Puretec, Inc., supra,* 290 F. Supp. at 719.

Under the allegations of this complaint, the consent decree involved here served as the functional equivalent of the contractual relationship referred to in *Mount Clemens.* According to the complaint, the consent decree required defendant-appellees to offer particular securities to a specific, identifiable group of non-stockholding retail users of Blue Chip Stamps, including plaintiff-appellant, and plaintiff-appellant had a right to buy those securities at a fixed price and in a fixed amount.[14] The complaint alleges an objective measure of the amount of loss, based on subsequent sales by defendants. As to causation, the complaint alleges that the consent decree offer was intended to be and was a bargain; that units of

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[14]As defendant-appellees point out, plaintiff-appellant could not have directly enforced the decree. *See* Dahl, Inc. v. Roy Cooper Co., 448 F.2d 17, 20 (9th Cir. 1971). Indeed, the district court dismissed a claim based upon the theory that plaintiff-appellant's damage arose out of a violation of the consent decree, and that ruling was not appealed.

The rule referred to does not bar the claim before us, however. This claim rests upon the theory that plaintiff-appellant was damaged by a violation of the Securities Exchange Act of 1934 and Rule 10b-5 prohibiting fraud in connection with the purchase or sale of securities. The fact that the securities transaction that is the subject matter of the claim was mandated by the consent decree does not immunize defendant-appellees from the statutes and rules regulating securities transactions. Plaintiff-appellant relies upon a breach of a duty imposed by these statutory anti-fraud provisions, not upon a breach of a duty imposed by the consent decree.

securities having a market value of $315 were to be offered to plaintiff-appellant for $101 — a difference so great as to provide, prima facie, an objective basis for a factual inference that users properly informed rather than misled would have accepted the offer.[15] It is also alleged that 60 per cent of those non-stockholding users who did purchase the units offered them had information as to value not made available by defendant-appellees in the prospectus.

The facts foreshadowed by plaintiff-appellant's allegations may not be forthcoming, or the suggested inferences may be shown to be untenable. If such deficiencies become apparent in pretrial proceedings, they will justify judgment short of trial. *Walling v. Beverly Enterprises, supra,* .... F.2d at .... We hold only that dismissal on the face of the complaint was premature.

Reversed and remanded for further proceedings.

HUFSTEDLER, Circuit Judge, dissenting:

The majority confers standing to bring private damage actions under section 10(b) and Rule 10b-5 upon persons who neither bought nor sold securities and who never contracted with anyone to do so. I cannot reconcile this result with existing authority in our circuit and elsewhere or with the legislative scheme of which the section and the rule are a part. The majority's justification for the result is that these nonpurchasing appellants, as members of a class benefited by a consent divestiture decree in an action to which they were not parties, had a special status that was "functionally equivalent" to the status of an in-

[15]An informed decision by plaintiff-appellant to purchase these shares could not have been thwarted by the intervention of an earlier or higher bidder, as in Mount Clemens Industries, Inc. v. Bell, 464 F.2d 339, 346 n. 11 (1972).

vestor who had a contract to buy or to sell securities. I perceive no analogy between the two and no sound reason to create a fiction to expand the reach of section 10(b) damage actions.

The result reached by the majority is inconsistent with the holding and reasoning of this court's recent decision in *Mount Clemens Industries, Inc. v. Bell* (9th Cir. 1972) 464 F.2d 339. *Mount Clemens* held that the purchaser-seller rule governs standing to bring section 10(b) damage actions in the courts of this circuit. The court then concluded that the noncontractual status of the *Mount Clemens* nonbuyer was fatal to the maintenance of his section 10(b) claim. Similarly, the noncontractual status of the nonbuyer appellants herein should be held to bar their suit.[1]

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[1]Unless some relevant distinction between the nonpurchasers in this case and the nonpurchasers in *Mount Clemens* can be asserted, appellants herein must, on authority of *Mount Clemens*, be denied standing. To be significant, the distinction must be one which would have made a difference in outcome under the reasoning of *Mount Clemens*.

The majority opinion explicitly suggests only one distinguishing feature between the two cases: "An informed decision by plaintiff-appellant to purchase these shares could not have been thwarted by the intervention of an earlier or higher bidder, as in Mount Clemens . . . ." This distinction, however, is irrelevant.

The *Mount Clemens* court made it clear that the difficulty that plaintiffs therein would have had in proving that they could have purchased the securities in question was not of governing significance in that case: "While we agree with the District Court that the claim of the appellants is highly speculative, that circumstance alone could not necessarily deprive them of the opportunity to prove a set of facts entitling them to relief." 464 F.2d 346 n.11. The court then went on to indicate the factor that was of governing significance: "The lack of an agreement, however, does distinguish the present case from those decisions which permit aborted purchasers and sellers to maintain an action for damages." *Id.*

The distinction through which the majority in this case seeks to avoid the result in *Mount Clemens*, therefore, is irrelevant, for

The majority, however, attempts to bring appellants within the class of protected investors by saying that the consent decree is the "functional equivalent of the contractual relationship referred to in *Mount Clemens.*" The majority means that appellants' status under the consent decree is analogous to that of purchasers or sellers whose contracts to buy or to sell aborted because of deceptive practices forbidden by section 10(b) and who were given standing to sue in cases that were cited and distinguished in *Mount Clemens.*

The functions of a contract and of the consent decree are, however, not equivalent. A contract to purchase or to sell a security is the equivalent of a purchase or a sale because the statute by definition makes them equivalent.[2] As *Mount Clemens* explained, the unifying link among the cases granting standing to persons who did not buy or sell "is the existence of a contractual relationship between the parties which elevated the plaintiff to the status of statutory purchaser or seller." (464 F.2d at 345.) A consent divestiture decree cannot function similarly because it is not a "contract" within the meaning of the statute and because no statutory provision equates "purchase"

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even if the claim of the plaintiffs in *Mount Clemens* had been less speculative than the appellants' claim in this case, the result in *Mount Clemens* would have been the same. Because plaintiffs therein would nonetheless have been neither actual buyers nor contractual "purchasers", they would have been denied standing. Similarly, if the outcome in this case is to be in accord with the reasoning in *Mount Clemens*, appellants must be denied standing because appellants in this case neither actually acquired shares nor entered into contracts for their acquisition.

[2]Securities Exchange Act of 1934, § 3(a), 15 U.S.C. 78c(a):

". . . .

"(13) The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire.

"(14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

and "offer pursuant to a consent decree." The essential statutory link between the appellants and "purchasers" is missing.

The gap cannot be filled by saying, as does the majority, that a contract and the consent decree render causation and damages equally provable. Assuming that this similarity exists, it is nonetheless irrelevant. The court in *Mount Clemens* concluded that the speculativeness of a cause of action was not a ground for denying standing. (464 F.2d 346 n.11.) If speculativeness will not impair standing, a want of speculativeness cannot support standing. The ability of a plaintiff to prove causation and damages is relevant to the disposition of the merits, not to a determination of whether or not a certain plaintiff is properly before the court.

Furthermore, the appellants' ability to prove causation and damages cannot be likened to that of parties who have contracted to buy or sell. Their situations are dissimilar because a contract creates legal rights between the parties. Appellants had no duties and no rights created by the consent decree. The decree could not have been enforced against them, and they could not have enforced it, even if the parties to the action resulting in the decree had intended to benefit them specifically. *(E.g., Buckeye Co. v. Hocking Valley Co.* (1925) 269 U.S. 42; *United States v. ASCAP* (2d Cir. 1965) 341 F.2d 1063; *Control Data Corp. v. IBM Corp.* (D. Minn. 1969) 306 F. Supp. 839, *aff'd sub nom. Data Processing Financial & General Corp. v. IBM Corp.* (8th Cir. 1970) 430 F.2d 1277. *See Dahl, Inc. v. Roy Cooper Co.* (9th Cir. 1971) 448 F.2d 17, 20.[3] Because the consent decree creates no rights or

[3]A persuasive rationale for refusing to accord nonparties standing to enforce a consent decree is that the potential exposure to litigation and to liability that a contrary rule would engender would seriously impair the settlement of litigation. The public

duties in appellants, their commitment and ability to purchase the offered securities are far less definite than in a case in which a contract binds the parties. This want of definiteness renders appellants far less able to prove causation and damages than those who have contracted to buy securities and negates the "functional equivalence" that is the basis for the majority's grant of standing.

The foregoing analysis suggests that the majority does not succeed in bringing appellants within the ambit of the standing rule established in *Mount Clemens;* indeed, it does not really attempt to do so. The "functional equivalent" language masks the majority opinion's real purport, which is the creation of an exception to the purchaser-seller rule.[4] The opinion attempts to justify

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interest in obtaining consent decrees outweighs the interest of the nonparty litigants in obtaining direct vindication of their private interests. Control Data Corp. v. IBM Corp. (D. Minn. 1969) 306 F. Supp. 839, 846. If administration of the antitrust laws would be ill served by allowing direct enforcement of consent decrees by third parties, it is difficult to understand how it would be better served by the creation of "rights", like that created by the majority opinion, that permit indirect enforcement of the decrees.

[4]The purchaser-seller rule has heretofore been understood to dictate that if a plaintiff in a section 10(b) private damage action is neither a purchaser nor a seller, he does not have standing to sue. To justify its conclusion that appellants have standing, therefore, the majority either must conclude that appellants are purchasers or sellers or must seek to modify the previously established meaning of the purchaser-seller requirement. The former conclusion cannot be sustained. The majority opinion, therefore, must be viewed as arguing for the latter conclusion.

The majority in essence establishes a second basis upon which to claim standing. Under the logic of the majority opinion, a plaintiff may bring suit if either he is a purchaser or seller or he is able to prove causation and damages. The purchaser-seller rule ceases to be operative in all cases; its applicability becomes conditional upon the plaintiff's inability to prove his cause of action.

The majority apparently believes that this is no departure from prior precedent, for it writes of "the cases allowing non-purchasers

the exception by (1) implying that the purchaser-seller rule is grounded solely on a policy of denying standing where either causation or damages is dubious,[5] and (2) arguing that appellants should have standing because they could prove both elements. Neither proposition withstands scrutiny.

Although the purchaser-seller rule is occasionally buttressed by observations about the difficulties of proof that would accompany an abandonment of the rule, no authority purports to say that the potential for proving causation and damages is the essence of the rule. On the contrary, a person who is either a purchaser or seller and who alleges deception, causation, and damages can bring the action even if his ability to prove his case is nil. *(Cf. Mount Clemens Industries, Inc. v. Bell,* 464 F.2d 339, 346 n.11.) He may promptly lose on a motion for summary judgment, but his action cannot be dismissed for lack of standing. The majority opinion's effort to find sustenance for its view of the purpose of the purchaser-seller requirement in suits seeking only injunctive relief is unavailing.

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or non-sellers to sue for damages under the statute and rule." No cases allowing such plaintiffs to sue are cited. Concededly, the majority cites several cases in which the strict purchaser-seller rule was relaxed somewhat. The relaxation that those cases countenance, however, is of a different sort altogether than that which the majority proposes. The majority proposes to uncouple the standing requirement from the purchaser-seller rule. The "forced seller" and "aborted purchaser-seller" cases to which the majority refers suggest only that the words "purchaser" and "seller" be liberally defined. They do not suggest that the words become altogether irrelevant and the rule of which they are a part become inoperative in certain contexts.

[5]If the majority were to fail to assert that this policy is the sole basis for the purchaser-seller rule, the logic of the opinion would fail. Even though some policies underlying the standing requirement were satisfied in a given case, if there were also other purposes to be met, standing would not properly be granted unless the majority were to show that the other policies also were not ill served by allowing appellants to sue.

The purchaser-seller rule has only peripheral relationship to suits for an injunction.[6] A rule that no one could obtain preventive relief who could not prove that the fraud had already been consummated would be quixotic. Moreover, expansion of standing to bring suits for injunctive relief does not entail the risk of strike suits or of exposure to imponderable liability that expanded standing in damage actions threatens.

The assertion that appellants are peculiarly able to prove causation and damages and thus are separable from all other nonbuyers is also faulty. The quantity of shares offered, the price, and the time of sale are generally fixed in a securities offering. These factors, therefore, do not distinguish the offer to appellants from an offer of the same securities to the general public. Although the majority opinion says that the appellants' expectations are "rights," they are not legally cognizable rights. If the offer were withdrawn or the decree not complied with, appellants could not complain. The susceptibility of appellants' expectations to being so frustrated renders appellants' damages as difficult to prove as those of a plaintiff whose acceptance of an offer is "thwarted by the intervention of an earlier or higher bidder." Nor is it the case that causation is more easily proven by appellants than by a nonpurchasing public offeree. The majority opinion states, "ordinarily there will be little proof (other than the non-purchaser's own opinion, after the loss) that the non-purchaser would in fact have purchased but for the fraud . . ." The majority's position is reasonable, but irrelevant. One who has the opportunity

[6]Of the three cases cited by the majority, none explicitly discussed the purchaser-seller requirement, and two involved plaintiffs who were in fact purchasers or sellers. Britt v. Cyril Bath Co. (6th Cir. 1969) 417 F.2d 433, 435. *Compare* Rekant v. Desser (5th Cir. 1970) 425 F.2d 872, 876-79 *with id.* 879-82.

to purchase securities may let the opportunity pass for want of ability to take it, for failure to notice the opportunity, or for misjudgment of the market. These considerations apply as strongly to appellants' case as they do to the case of public offerees. Appellants were as free to decline the bargain for the same reasons as any other nonbuyers. Appellants are in no better position than the public offerees to claim that if they had known the truth, they would have snapped up the bargain. The argument that a person not only adequately alleges damages, but also prima facie proves causation by stating a marked disparity between the value of the security and the offering price is startling. Any nonbuyer or nonseller could easily leap the causation hurdle if that proposition were true.

Appellants are therefore in the same legal position as were the nonbuying members of the general public to whom the same securities were subsequently made available by the consent decree and who, as appellants concede, have no standing to bring a section 10(b) damage action. Appellants cannot explain why their own situation is essentially different from other nonbuyers, except that they are a more discrete group than the general public and their disappointment can be assuaged for no more than $21,000,000, rather than many times that amount. Absent such a difference, the exception to the purchaser-seller rule that the majority seeks to establish is unjustifiable.

At the heart of the majority's inability to justify its exception to the purchaser-seller rule is what I believe to be a basic misunderstanding of the role of a standing requirement in the context of securities litigation. The majority apparently believes that any plaintiff who can credibly allege the substantive elements of a cause of

action should be granted standing. However, even if litigants can allege and even prove all of the elements of a section 10(b) damage claim, they nonetheless may lack standing. The standing doctrine is not designed to thwart actions by persons who have not suffered any injury from a wrong. It is a means of foreclosing actions by persons who have been hurt by wrongs, but who, for reasons of legislative, judicial, or social policy, are outside of the class of persons who are given a particular kind of remedy for the injury.[7] A federal standing requirement insures that litigants are sufficiently adverse to satisfy the case or controversy requisite of Article III of the Constitution, and it confines the persons who may bring suit to those whom Congress intended to provide the remedy invoked in a particular controversy. Appellants do not have standing because they are outside the class to whom Congress intended to extend the right to bring federal damage actions when it enacted section 10(b).

Congress could have preempted state law controlling deceptive practices in the marketing of these securities, and it could have given anyone injured by the practices condemned by section 10(b) a private federal damage remedy. It did neither. Instead, Congress created a scheme of private and public remedies superimposed upon state statutory and common law remedies. When confronted with a complex legislative scheme of this kind, the judiciary must be extremely careful not to upset the balances built into the scheme by lightly implying federal remedies or by diluting principles of standing. *(Cf. SEC*

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[7]The Supreme Court has described the law of standing as a "complicated specialty of federal jurisdiction, the solution of whose problems is in any event more or less determined by the specific circumstances of individual situations." United States *ex rel.* Chapman v. Federal Power Comm'n (1953) 345 U.S. 153, 156.

v. National Securities, Inc. (1969) 393 U.S. 453, 465, 467 n.9; *Holloway v. Bristol-Myers Corp.* (D.C. Cir. 1973) ..... F.2d .....)

An expansive definition of the class given standing to pursue section 10(b) damage actions promises some incremental benefit in preventing deceptive practices in the marketing of securities, one of the principal purposes of the section. Expanding the class, however, entails costs as well as benefits. Incautious loosening of the purchaser-seller rule will generate federal litigation, increase the cost of marketing securities,[8] inject into securities marketing new risk factors that defy accurate assessment, expose offerors to draconian damage claims, and invite strike suits.[9] Securities markets are complex and sensitive institutions. Opening the valve, even a little, that controls the flow of section 10(b) damage actions can so far unsettle the market as to defeat, rather than to promote, the benevolent purposes of Congress in enacting

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[8]Under the majority's rule, securities traders would not only have to insure against potentially crippling damages, they would also have to bear increased compliance costs. The accuracy of a representation with regard to a security is usually judged by hindsight; if the price of the security rises substantially, prior representations may seem unduly conservative; if it falls, too optimistic. Under the purchaser-seller rule, offerors can protect themselves against unforseen impositions of liability by acting with judicious restraint when dealing with others; they need merely avoid inaccuracies that induce others to act. If passive "investors" were also allowed to sue, such self-protective conservatism might prove suicidal, for an offeror would have to be micrometrically accurate. If securities traders are to be held responsible for lapses in such exactitude, the costs of accumulating, verifying, and presenting the necessary data would soar.

[9]The great ease with which plaintiffs can allege the requirements for the majority's standing rule and the greater difficulty that plaintiffs are going to have proving the allegations suggests that the majority's rule will allow a relatively high proportion of "bad" cases into court. The risk of strike suits is particularly high in such cases; although they are difficult to prove at trial, they are even more difficult to dispose of before trial.

the statute. *(Cf. Herpich v. Wallace* (5th Cir. 1970) 430 F.2d 792, 804.)

The purchaser-seller rule has maintained the balances built into the congressional scheme by permitting damage actions to be brought only by those persons whose active participation in the marketing transaction promises enforcement of the statute without undue risk of abuse of the litigation process and without distorting the securities market.

The majority implies that its exception to the purchaser-seller rule does no real harm because few litigants will be situated exactly as were these appellants. In my view, the majority underestimates the ingenuity of counsel, but, even if it did not, the position is jurisprudentially unsound because it does not create neutral principles of law. In drawing the standing line between deceived nonbuyers given closed-end opportunities to purchase securities pursuant to a consent decree (appellants) and deceived nonbuyers given opportunities to purchase securities on a while-they-last basis pursuant to the same consent decree (nonbuyer public investors), the majority has not supplied a rationale keyed to the statute and rule to support its conclusion.[10] Without such an underlying rationale, there are no neutral principles preventing the majority's "causation and damages" or "functional equivalence" terminology from being extended to all passive "investors".

To expand standing to nonsellers or to nonbuyers, like appellants, who have taken no affirmative action of any

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[10]The majority opinion would allow standing to sue if the misled non-buyer were one of 10 offerees who could buy no more than 10,000 shares each of a 100,000-share offering, but it would deny standing if the non-buyer were identically misled as to the same shares, but he was one of 11 offerees of 10,000 shares of the same offering to be sold on while-they-last terms. Why?

kind in reliance upon alleged deceptive statements invites litigation that has nothing to do with protecting the integrity of the marketing of securities. The passive investor could always await market developments without any risk, claiming deception caused nonbuying if the value of the securities proved more promising than the offerors' glum predictions and deception caused nonselling if a rosier prospectus was followed by a market decline. Meanwhile, securities offerors would be hard pressed to find language for prospectuses that would be sufficiently neutral to avoid potential damage suits from bystanders.

I would affirm.

Appendix B

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MANOR DRUG STORES AND ALL OTHER USERS OF BLUE CHIP STAMPS WHO WERE ENTITLED BUT FAILED TO PURCHASE STOCK OF BLUE CHIP STAMPS, ON BEHALF OF THEMSELVES AND ALL OTHER PERSONS SIMILARLY SITUATED,

Plaintiffs-Appellants,

v.

BLUE CHIP STAMPS, a corporation, BLUE CHIP STAMP COMPANY, a merged corporation, LUCKY STORES, INC., MARKET BASKET, a corporation, PURITY STORES, INC., RALPHS GROCERY COMPANY, a corporation, SAFEWAY STORES, INC., THRIFTIMART, INC., THRIFTY DRUG STORES CO., INC., VONS GROCERY CO., a corporation, ROBERT E. ALEXANDER, DONALD A. KOEPPEL, LEONARD H. STRAUS, WILLIAM F. RAMSEY, ROBERT E. LAVERTY, RICHARD RALPHS, JOHN R. NIVEN, FRED VON DER AHE,

Defendants-Appellees.

No. 71-2223
ORDER

[Filed April 1, 1974]

Before: BROWNING, HUFSTEDLER, and CHOY, Circuit Judges

The majority opinion filed herein October 15, 1973, is modified as follows:

(1) The first sentence, first paragraph, slip opinion page [A-10], now reads:

Under the allegations of this complaint, the consent decree involved here serves the same function as did the contractual relationship referred to in *Mount Clemens.*

(2) The following new paragraph has been added prior to the concluding "disposition" line, slip opinion page [A-11]:

This holding does not undermine *Mount Clemens.* The allegations of the present complaint describe a highly unusual situation in which an unyielding insistence upon the existence of a contract to purchase as a prerequisite to relief would subordinate substance to form.

To meet the modifications in the language of the majority opinion, Judge Hufstedler makes the following changes in the dissenting opinion:

(1) From the first paragraph of the dissent, third sentence (slip opinion page [A-11]), delete the quote marks and strike the word "functionally."

(2) In the first full paragraph (slip opinion page [A-13]) line [3], change "is the 'functional equivalent of" to "serves the same function as did." Delete the quote mark at line 4.

(3) From the [second] paragraph (slip opinion page [A-13]), strike from the second line the word "equivalent" and substitute therefor the words "the same".

(4) At line [6] (slip opinion page [A-15]) change "'functional equivalence'" to "'same function' conclusion."

(5) From the first full paragraph (slip opinion page [A-15]), second sentence, change "The 'functional equivalent' language" to "To state that the consent decree serves the same function as a contract".

(6) In the [second] full paragraph (slip opinion page [A-21]), penultimate line, change "'functional equivalence'" to "'same function'".

The petition for rehearing is denied.

A majority of the court having voted to reject the suggestion for rehearing in banc, the suggestion is rejected.

Judges Koelsch, Ely, Hufstedler, Trask, and Wallace have requested that it be recited that they voted to rehear the case in banc.

Appendix C

MANOR DRUG STORES, etc., Plaintiff,

v.

BLUE CHIP STAMPS, a corporation, et al., Defendants.

No. 70-2539.

United States District Court,
C. D. California.
[May 25, 1971]

OPINION AND ORDER GRANTING DEFENDANTS' MOTION TO DISMISS

KELLEHER, District Judge.

Plaintiff brought this action for actual and exemplary damages as a result of defendants' alleged misleading representations in connection with the offer of certain securities of a corporation reorganized pursuant to a consent decree and final judgment entered by this Court in United States v. Blue Chip Stamp Co. (C.D.Calif., June 5, 1967) Civil No. 63-1552-F, an action arising under the antitrust laws against Blue Chip Stamp Co. (hereafter old Blue Chip) and nine of its shareholder corporations, named defendants herein along with certain directors of old Blue Chip and Blue Chip Stamps, a corporation, (hereafter new Blue Chip).

The consent decree provided in section V:

> Blue Chip is ordered and directed to present to the Court . . . a plan for the reorganization of Blue Chip Stamp Company . . . Upon approval of the plan by the Court shall make bona fide and diligent efforts to reorganize the company pursuant to the said plan;

and in section VII further provided:

> In the event that Section V becomes inapplicable, Blue Chip may also enter into a reorganization pursuant to a plan for the reorganization of Blue Chip Stamp Company acceptable to the Court.

The reorganization plan adopted by the Court provided, inter alia, for the formation of new Blue Chip and ordered that an:

> . . . offering of approximately 621,600 shares of its Common Stock will then be made by New Company to users of Blue Chip Stamps (who issue stamps to their retail customers as a reward for patronage) other than users who are also shareholders of Blue Chip (such users to whom such offering is made are hereinafter referred to as "Users") on a pro rata basis determined by the quantity of stamp pads issued to Users during the period subsequent to March 1, 1964, and prior to a date to be determined which will be not more than 90 days prior to the effective date of the registration statement hereinafter referred to.

The reorganization plan then went on to require registration of the offering under the Securities Act of 1933 and further prescribed that in the event portions of the offering went unsubscribed at the termination of the offering, the unsubscribed shares were to be disposed of by appropriate action of the directors of new Blue Chip. Thereafter, according to the amended complaint, an offering of new Blue Chip "units," consisting of a $100 principal amount debenture and three shares of new Blue Chip Common at a total cash consideration of $101.00, were tendered to the users by means of a prospectus dated August 29, 1968; the offering required the users to exercise their rights on or before November 29, 1968. Plaintiff alleges that the Court intended the offering to be a bargain for the users in compensation for the damages they

allegedly suffered as a result of old Blue Chip's antitrust violations. However, the offering shareholders purportedly had no intention of complying in good faith with the terms of the consent decree and permitting the users to exercise their rights under the offer and accordingly conspired to dissuade the users from purchasing the units by including misleading statements in the prospectus; specifically, the amended complaint alleges that the prospectus stated new Blue Chip's income and net earnings would be adversely affected by payment of certain claims against the company and by a substantial decrease in the use of the firm's trading stamp service. As a result of these alleged misrepresentations, plaintiff asserts that it and the other users it claims to represent were induced not to purchase the tendered units and, thereby, suffered damages which it seeks to recover by this action.

Plaintiff contends that the offering shareholders' and directors' alleged misrepresentations violate section 12 of the Securities Act of 1933 [15 U.S.C. § 77*l*] and section 10(b) of the Securities & Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Securities & Exchange Commission Rule 10b-5, promulgated thereunder. A fourth cause of action asserted under pendent federal jurisdiction alleges that plaintiff is a third party beneficiary under the consent decree and that the offering shareholders' and directors' actions breached their duty to plaintiff who may recover therefor. Defendants have moved to dismiss the amended complaint as failing to state a cognizable federal claim; for purposes of these motions, of course, the Court will take the allegations of the amended complaint as true.

PLAINTIFF'S CLAIM TO BENEFICIARY STATUS

[1] Plaintiff claims that the consent decree of June 5, 1967, sought to redress old Blue Chip's alleged antitrust

violations by affording non-shareholders of old Blue Chip's trading stamp service, such as plaintiff, the opportunity to become shareholders in a newly organized Blue Chip company at what plaintiff describes as a "bargain basement price." Since the Court intended to benefit plaintiff and other non-shareholder users, plaintiff infers that the offering shareholders owed plaintiff a duty which was breached by the alleged misrepresentations for which plaintiff may recover in Federal Court. Plaintiff's argument is as unmeritorious as it is imaginative.

[2, 3] It appears well established that a non-party to an antitrust decree cannot attempt to enforce the decree against the defendant, even though the decree was intended to directly or indirectly benefit the non-party. Accordingly, a non-party does not have standing to punish a defendant for contempt of a decree entered in an antitrust action by the United States which retains the opportunity to enforce or modify the terms of the decree. United States v. American Soc. of Composers, Auth. & Pub., 341 F.2d 1003, 1008 (2d Cir. 1965), cert. denied, 382 U.S. 877, 86 S.Ct. 160, 15 L. Ed.2d 119 (1965). The fact that the decree was intended to benefit certain non-parties does not confer on them an independent cause of action for violations of the decree. Control Data Corp. v. International Bus. Mach. Corp., 306 F.Supp. 839 (D.Minn. 1969), aff'd 430 F.2d 1277, 1278 (8th Cir. 1970). In *Control Data,* plaintiffs were barred from asserting defendants' alleged violations of two prior consent decrees even though plaintiffs did not per se seek to enforce the provisions of the earlier decrees and even though the decrees clearly intended to benefit defendants' competitors, including plaintiffs. The District Court reasoned that to permit private third parties to assert consent decree violations against antitrust defendants would considerably diminish their incentive to enter into such

decrees as well as hinder the Government's ability to obtain consent decrees in appropriate cases. Control Data Corp. v. International Bus. Mach., *supra*, at 846.

Plaintiff's attempt to distinguish the *Control Data* case by the fact that not all plaintiffs in *Control Data* were in existence at the time of the decrees therein is untenable since the very purpose of the decree was to stimulate competition, including the formation of new firms, in the relevant industry. Moreover, even though *Control Data* involved a private antitrust claim by the third party, there appears to be no reason why the rule of that case should not apply with equal, if not greater, force where the plaintiff, as herein, pleads a non-antitrust cause of action which depends on the prior decree. The Court concludes that if plaintiff is to have any action for defendants' alleged misrepresentations, its claim must stand or fall on the provisions of the securities law which it asserts defendants have violated.

'33 ACT, SECTION 12

[4] Section 12 of the Securities Act of 1933 provides that any person who fraudulently sells a security in interstate commerce or through the use of the mails ". . . shall be liable to the person purchasing such security. . . ." See Greater Iowa Corp. v. McLendon, 378 F.2d 783, 789, 790 (8th Cir. 1967), affirming the dismissal of an issuer's complaint attacking the validity of minority shareholders' voting trust and stating that § 12(2) was not designed to afford protection to persons who are not investors nor those not in privity with them. Slack v. Stiner, 358 F.2d 65 (5th Cir. 1966). Slavin v. Germantown Ins. Co., 174 F.2d 799 (3d Cir. 1949), rev'g on other grounds 74 F.Supp. 876 (E.D.Pa.1947). Since this section of the Act expressly limits recovery to private litigants

who qualify as "purchasers," it clearly has no application to the present action where the gravamen of the amended complaint is that due to defendants' alleged fraud plaintiff was induced not to purchase the offered securities.

'34 ACT, SECTION 10 AND RULE 10b-5

[5] Section 10 of the '34 Act makes unlawful the use of ". . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities & Exchange] Commission may prescribe. . . ." Thereunder, the Commission has promulgated Rule 10b-5, which provides:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange.
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, *in connection with the purchase or sale of any security.* (emphasis added) [17 C.F.R. § 240.10b-5]

Both parties state that the Ninth Circuit Court of Appeals has not had occasion to rule whether an offeree, such as plaintiff, who has not in fact purchased or sold securities as a result of conduct fraudulent within the

meaning of the Rule, may recover damages in a private civil action. There has, however, been considerable discussion of the problem elsewhere.

The watershed case appears to be Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952), cert. denied, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952), holding that Rule 10b-5 does not sanction private recovery by a minority shareholder who complained of an insider's sale of corporate control without affording the minority shareholders an opportunity to sell their shares at the same price. However, to fully effectuate the purpose of the Rule, the *Birnbaum* decision has generally been given a fairly restrictive interpretation by limiting its application to situations where the plaintiff was not a party to a purchase or sale transaction. See the dissent of Frank, J., in Joseph v. Farnsworth Radio & Television Corp., 198 F.2d 883 (2d Cir. 1952). Indeed, the exceptions or limitations to an across the board application of the *Birnbaum* doctrine are legion, usually resting upon a liberal construction of what constitutes a purchase or sale for purposes of Rule 10b-5; thus, for example, where defrauded sellers are induced or forced to postpone their sale, an action under Rule 10b-5 will lie, Stockwell v. Reynolds & Co., 252 F.Supp. 215 (S.D.N.Y. 1965), Opper v. Hancock Securities Corp., 250 F.Supp. 668 (S.D.N.Y.1966), aff'd 367 F.2d 157 (2d Cir. 1966); a minority shareholder was deemed a forced seller for purposes of Rule 10b-5 even though he had neither accepted defendant's tender offer nor surrendered his stock pursuant to a "short form" merger, Vine v. Beneficial Finance Co., Inc., 374 F.2d 627 (2d Cir. 1967), cert. denied, 389 U.S. 970, 88 S.Ct. 463, 19 L.Ed.2d 460 (1967); nor does it appear a consummated purchase or sale is required to invoke operation of the Rule, Commerce Reporting Co. v. Puretec, Inc., 290 F.Supp. 715, 718 (S.D.N.Y. 1965). Without question, such

broad interpretations of the Rule are both sound and necessary in order to vitalize the antifraud purposes of the Rule and the securities laws. S.E.C. v. National Securities, Inc., 393 U.S. 453, 89 S.Ct. 564, 21 L.Ed.2d 668 (1969).

Nonetheless, the Court considers the Rule's application properly limited to situations where the defrauded party can show actual damages, not merely the loss of a possible gain contingent upon factors which never came into existence. 15 U.S.C. § 78bb(a). Plaintiff's case aptly demonstrates the soundness of so limiting operation of the Rule; the causal nexus between defendants' alleged misrepresentations and plaintiff's failure to purchase the Blue Chip "units" depends upon a number of highly uncertain factors such as proof that but for defendants' misrepresentations plaintiff would have, indeed, purchased the offered "units;" the Court doubts that plaintiff, if permitted to maintain this action, could satisfactorily carry the burden of such proof; in view of this uncertainty, damages herein appear highly speculative. Kremer v. Selheimer, 215 F.Supp. 549, 552, 553 (E.D.Pa. 1963). This uncertainty is not, it is believed, peculiar to plaintiff's case but applies to any party who, like plaintiff, has not in fact entered into a transaction having the effect of a purchase or sale of securities; since the securities laws do not sanction recovery for losses based on speculation or conjecture, the Court concludes that a party in plaintiff's position is not entitled to an action under these laws.

None of the numerous cases cited by plaintiff persuades the Court that the *Birnbaum* requirement of a purchase or sale has been discarded as an essential element for maintenance of an action under Rule 10b-5. Despite some fairly extensive criticism of the requirement and predic-

tions of its pending "demise," Entel v. Allen, 270 F.Supp. 60 (S.D.N.Y.1967), Lowenfals, "The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5," 54 Va.L.Rev. 268 (1968), the Court finds ample authority that the *Birnbaum* requirement retains validity and represents sound policy. Iroquois Industries, Inc. v. Syracuse China Corp., 417 F.2d 963, 967 (2d Cir. 1969), cert. denied, 399 U.S. 909, 90 S.Ct. 2199, 26 L.Ed.2d 561 (1970). Greenstein v. Paul, 400 F.2d 580, 581 (2d Cir. 1968). 3 Loss, Securities Regulation (2d ed. 1961) 1469. 6 Loss, Securities Regulation (Supplement 1969) 3620.

Upon the foregoing, it is hereby ordered that defendants' motions to dismiss are granted and the amended complaint is dismissed with prejudice.

Appendix D

15 U.S.C. §77k

§77k. Civil liabilities on account of false registration statement.

(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue —

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

(b) Notwithstanding the provisions of subsection (a) of this section no person, *other than the issuer,* shall be liable as provided therein who shall sustain the burden of proof —

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and ....

* * *

(e) The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided,* That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall

any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) of this section for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) All or any one or more of the persons specified in subsection (a) of this section shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

(Emphasis added.)

Appendix E

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[Filed January 27, 1971]

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Manor Drug Stores and all other users of Blue Chip Stamps who were entitled but failed to purchase stock of Blue Chip Stamps, on behalf of themselves and all other persons similarly situated,

Plaintiffs,

vs.

Blue Chip Stamps, a corporation, Blue Chip Stamp Company, a merged corporation, Lucky Stores, Inc., Market Basket, a corporation, Purity Stores, Inc., Ralphs Grocery Company, a corporation, Safeway Stores, Inc., Thriftimart, Inc., Thrifty Drug Stores Co., Inc., Vons Grocery Co., a corporation, Robert E. Alexander, Donald A. Koeppel, Leonard H. Straus, William F. Ramsey, Robert E. Laverty, Richard Ralphs, John R. Niven, Fred von der Ahe,

Defendants.

CIVIL NO. 70-2539-RJK

Amended Complaint for Breach of Contract, Fraud and Misrepresentation

JURY TRIAL REQUESTED

FIRST CAUSE

I

This action is instituted under the Securities Act of 1933 (15 U.S.C. §§ 77a, *et seq.*); under the Securities Exchange Act of 1934 (15 U.S.C. §§ 77a, *et seq.*); under § 10 of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) and Rule 10b-5 adopted thereunder; under § 12 of the Securities Act of 1933; and jurisdiction is founded on the Securities Act of 1933 (particularly, without limitation, § 22 thereof [15 U.S.C. § 77v]) and the Securities Exchange Act of 1934 (particularly, without limitation, § 27 thereof [15 U.S.C. § 78aa]); and jurisdiction is founded on the doctrine of pendent jurisdiction as to causes arising out of state law.

II

Plantiff is a corporation duly organized and existing under the laws of the State of California, with its principal place of business in the State of California, and brings this action in its own behalf and as a class action on behalf of others similarly situated in accordance with the provisions of Rule 23 of the Federal Rules of Civil Procedure for the United States District Courts.

III

The persons who constitute the class are so numerous that joinder of all members is impracticable; there are questions of law and fact common to the entire class; the claims of plaintiff are typical of the claims of the entire class and each member thereof; and the plaintiff will thoroughly and adequately protect the interests of the entire class and each member thereof.

IV

Defendants, ALEXANDER'S MARKETS, LUCKY STORES, INC., RALPHS GROCERY COMPANY, THRIFTIMART, INC., MARKET BASKET, and THRIFTY DRUG STORES CO., INC., are corporations, each of which has been organized and is existing under the laws of the State of California; defendant, PURITY STORES, INC., is a corporation organized and existing under the laws of the State of Nevada and is authorized to do business and is doing business in the State of California; defendant, SAFEWAY STORES, INC., is a corporation organized and existing under the laws of the State of Maryland and is authorized to do business and is doing business in the State of California; defendant, VONS GROCERY COMPANY, is a corporation organized and existing under the laws of the State of Delaware and is authorized to do business and is doing business in the State of California. Each of said defendants maintains its principal place of business in the County of Los Angeles, State of California, with the exception of LUCKY STORES, INC., which has its principal place of business in the County of Alameda, State of California, PURITY STORES, INC., which has its principal place of business in the County of San Mateo, State of California, and SAFEWAY STORES, INC., which has its principal place of business in the County of Alameda, State of California.

The said corporate defendants listed in this Paragraph IV were stockholders of BLUE CHIP STAMPS at the time of the offering hereinafter described and owned approximately ninety percent (90%) of its stock at said time.

V

Defendants, ROBERT E. ALEXANDER, DONALD A. KOEPPEL, FRED VON DER AHE, LEONARD H. STRAUS, DRUMMOND WILDE, WILLIAM H. DYER, JR., ROBERT E. LAVERTY, WILLIAM F. RAMSEY, and RICHARD RALPHS, are now and were at all times from the time of its incorporation in about July 1968, members of the Board of Directors of BLUE CHIP STAMPS. At all of said times defendant, ROBERT E. ALEXANDER, represented the interests of defendant, ALEXANDER MARKETS, on said board; defendant, FRED VON DER AHE, represented the interests of defendant, VONS GROCERY CO., on said board; defendant, LEONARD H. STRAUS, represented the interests of defendant, THRIFTY DRUG STORES CO., INC., on said board; defendant, DRUMMOND WILDE, represented the interests of defendant, SAFEWAY STORES, INC., on said board; defendant, WILLIAM H. DYER, JR., represented the interests of defendant, LUCKY STORES, INC., on said board; defendant, ROBERT E. LAVERTY, represented the interests of defendant, THRIFTIMART, INC., on said board; defendant, RICHARD RALPHS, represented the interests of defendant, RALPHS GROCERY COMPANY, on said board; and defendant, JOHN R. NIVEN, represented the interests of defendant, PURITY STORES, INC., on said board.

VI

In connection with and in furtherance of and as an integral part of the illegal and fraudulent scheme herein alleged, defendants directly and indirectly, by the use of the means and instrumentalities of transportation and communication in interstate commerce and by the use of

the mails, engaged in acts, practices, courses of business and manipulative and deceptive devices, all constituting and operating as a fraud and deceit upon the plaintiffs as untrue and misleading statements of material facts and omission of material facts, which were intended to, and did, defraud plaintiffs.

In December, 1963, the United States of America, as plaintiff, filed in the United States District Court, Central Division of California, an action against Blue Chip Stamp Co. and nine of its twelve stockholders, including all of the corporations named as defendants herein except the defendant, Blue Chip Stamps, which was not then in existence, charging violations under the Sherman Anti-Trust Act, said action being entitled United States of America, plaintiff vs. Blue Chip Stamp Co., et al., defendants, bearing civil action No. 63-1552-F, which action is sometimes hereinafter referred to as the "Government Case."

As a result of said action, a Consent Final Judgment (sometimes herein referred to as "Consent Decree") was made and entered by the United States District Court on or about June 5, 1967, which, among other things, provided that the defendant corporations present to the Court for its approval a plan for the reorganization of Blue Chip Stamp Co. A true copy of said Consent Decree is attached hereto as Exhibit "A" hereof and incorporated herein.

Pursuant to said Consent Decree, said defendant corporation submitted to the Court a plan of reorganization of Blue Chip Stamp Co., which plan was thereafter approved by said Court and incorporated into said Final Consent Decree. A true copy of said plan of reorganization and order approving said plan is attached hereto with certain conditions as Exhibit "B" hereof and incor-

porated herein, and is sometimes hereinafter referred to as "The Plan."

The Plan required among other things the formation of a "new company," which was later named BLUE CHIP STAMPS, one of the defendants herein, and required the merger of defendant Blue Chip Stamp Co. into said BLUE CHIP STAMPS.

VII

Among the provisions of The Plan was the following:

"An offering of approximately 621,600 shares of its common stock would then be made by New Company (defendant BLUE CHIP STAMPS) to users of BLUE CHIP STAMPS (who issue stamps to their retail customers as a reward for patronage) other than users who are also shareholders of BLUE CHIP (such users to whom such offering is to be made are hereinafter referred to as "Users") on a pro rata basis determined by the quantity of stamp pads issued to Users during the period subsequent to March 1, 1964, and prior to a date to be determined which will be not more than ninety (90) days prior to the effective date of registration statement hereinafter referred to. The offering will be made in units consisting of three (3) shares of the common stock of New Company (defendant BLUE CHIP STAMPS) and one (1) One Hundred Dollars ($100.00) principal amount debenture for a cash consideration of One Hundred One Dollars ($101.00)."

VIII

Said Consent Decree further provided that in the event all of said 621,600 shares were not purchased by the Users the defendant, BLUE CHIP STAMPS, would be per-

mitted to sell the shares not so purchased at the then reasonable market value of said shares.

The above provisions of The Plan were included for the purpose of complying with the Court's direction that the defendants divest themselves of a total of about fifty-five percent (55%) of their holdings in the reorganization of the defendant, BLUE CHIP STAMP COMPANY, by its merger into BLUE CHIP STAMPS.

IX

Among the parties appearing in said Government case were the Attorney General of the State of California in behalf of Users other than Users who were also stockholders of BLUE CHIP STAMP COMPANY, and several users individually and in trade association.

All of said Users in this paragraph contended before the Court that they, in fact, owned an interest in the defendant, BLUE CHIP STAMP COMPANY, and the Twenty Million Dollars ($20,000,000) in profits it had accumulated during the five (5) years immediately prior thereto, and that in any decision of the said government case, the ownership of said users of an interest in the said defendant, BLUE CHIP STAMP COMPANY, and BLUE CHIP STAMPS should be decreed.

X

The claims and contentions by and on behalf of the users, as aforesaid, prompted the provisions of The Plan and the offering of three (3) shares of common stock and one (1) One Hundred Dollars ($100.00) principal amount debenture (hereinafter sometimes referred to as a "Unit") to the users for a cash consideration of One Hundred One Dollars ($101.00) which offering was a bargain, was in-

tended by the Court in the government case as a bargain, was recognized by the defendants herein as a bargain, and was intended by the United States of America, as plaintiff in the Government case and was, in fact, a bargain. It was the purpose and intent of the said Consent Decree and The Plan that the Users as described therein would benefit from the bargain purchase provided in the said Court Decree and Plan.

XI

The reasonable market value of the said Units at the time of the offering that was made pursuant to The Plan was, and still is, at least Three Hundred Fifteen Dollars ($315.00), of which Seventy-Five Dollars ($75.00) represented the reasonable market value of one (1) debenture and Eighty Dollars ($80.00) the reasonable market value of one (1) share of stock. The net bargain provided by said offering was, therefore, approximately $71.33 per share or $214.00 per unit.

XII

In compliance with said Consent Decree and The Plan, the defendant, BLUE CHIP STAMPS ("New Company") was formed in about July, 1968, and issued 621,000 [sic.] shares of stock to the stockholders of BLUE CHIP STAMPS COMPANY (of which approximately 560,000 shares went to the defendants herein); 27,600 shares were reserved for offering to certain of its employees; 10,400 shares were reserved for issuance pursuant to its qualified Stock Option Plan; and an additional 621,000 [sic.] shares were earmarked for offering to the Users of Blue Chip Stamps, including plaintiffs, pursuant to The Plan as set forth above.

Under the said Consent Decree and The Plan plaintiffs, as Users, were entitled to purchase approximately 100,000 Units or 300,000 shares of the 621,600 shares of defendant, BLUE CHIP STAMPS. Said units, as hereinabove alleged, in fact, being offered at One Hundred One Dollars ($101.00) each when they were worth, and known by the defendants to be worth, Three Hundred Fifteen Dollars ($315.00) per unit.

Under the said Consent Decree and The Plan, all of the members of the class suing herein, who failed to purchase said Units by reason of the facts set forth herein, were entitled to purchase the said 100,000 Units. That by not purchasing said Units at said price of One Hundred One Dollars ($101.00) per Unit, they were damaged in the amount of Twenty-One Million Four Hundred Thousand Dollars ($21,400,000.00).

XIII

As part of and pursuant to the said Consent Decree and The Plan, the defendants used the mails and other instrumentalities of inter-state commerce and caused defendant, BLUE CHIP STAMPS, to make the offering described above to the Users, including plaintiffs, of securities in Units described above through a certain Prospectus dated August 29, 1968 (hereinafter sometimes referred to as the Negative Prospectus), prepared and transmitted through the United States mail and other instrumentalities of inter-state commerce by the defendants in the name of the defendant, BLUE CHIP STAMPS. A true copy of said Prospectus is annexed hereto as Exhibit "C" and made a part hereof. Said Negative Prospectus and accompanying documents required the Users, including plaintiffs, to exercise their rights on or before November 29, 1968. At no time after said offering and neither before

nor after November 29, 1968, did defendants disclose to plaintiffs the true facts with respect to the value of said securities as herein set forth.

XIV

Defendants and each of them desired that the Users fail to exercise their rights under said Consent Decree, Plan and Prospectus to purchase the shares to which they were entitled, and, pursuant to said desire, said defendants, and each of them, conspired among themselves to accomplish said purpose, and said defendants, and each of them, did accomplish said purpose, by preparing and using said Prospectus as a manipulative and deceptive device and contrivance calculated to mislead and dissuade users not knowledgeable of the true value of said shares from purchasing said shares. That said Prospectus was employed as a device, scheme, and artifice to defraud the users, and said defendants, and each of them, were thereby engaged in an act, practice and course of business which operated and was intended to operate as a fraud and deceit upon the users in connection with the purchase of said shares. More specifically, said Prospectus, prepared as aforesaid, provided in part as follows:

(a) Commencing on page one in the fifth line thereof, defendants called attention to five "Items of Special Interests" appearing on page 2, all of which were negative and designed to mislead the Users, including plaintiff, as to the true value of the stock and thereby to dissuade them from purchasing, as hereafter set forth. Said "Items of Special Interests" were as follows:

"Prospective purchasers of securities offered herein shall particularly note the following items, each of which will be or may be adverse and which is discussed later in this Prospectus in greater detail:

(1) Net income from the current fiscal year will be adversely affected by payments aggregating Seven Million Nine Hundred Twenty-Eight Thousand ($7,928,000.00) Dollars made since March 2, 1968, in settlement of claims against the Company (See "Statement of Income and Retained Earnings" and "Litigation").

(2) Net income would be adversely affected by a substantial decrease in the use of Company's trading stamp service (See "Business — General").

(3) Net income would be adversely affected by a sale of one-third of the Company's trading stamp business in California; approximately ninety-nine percent (99%) of the Company's stamp service income is derived from its operations in California (See "Business — Effects of Consent Decree on Company's Operations").

(4) Claims or Causes of Action (as defined) against the Company, including prayers for treble damages, now aggregate approximately $29,000,000. The Company has agreed to indemnify Blue Chip Stamp Company and the present and former officers, directors and stockholders of the Company or Blue Chip Stamp Company from any liability or expenses arising out of certain claims asserted against any of them (See "Litigation").

(5) All but two of the present directors are precluded until June 5, 1977, from serving as directors after the first meeting of the Company's stockholders following the offer herein so long as they are employed by specified companies (See "Management").

Said five "Items of Special Interest" were thereafter referred to individually or collectively approximately

fifteen (15) times. Constant reference to said items was intended to, and did cause plaintiffs to be misled as to the true value of said shares. When the defendants themselves did, one year later, offer their own shares to the public at Ninety Dollars ($90.00) per share (allowing for a five-to-two stock split in the interim) by a Prospectus, a copy of which is attached hereto as Exhibit "D" and made a part hereof by reference (hereinafter referred to as "The Positive Prospectus"), no negative "Items of Special Interest" were set forth, nor was there reference to such items, although (to the extent they were relevant at the time of the Negative Prospectus) they were relevant at the time of the Positive Prospectus.

(b) Commencing in the second paragraph on page one of the Negative Prospectus there was reference to "Claims or Causes of Action" against the defendant, BLUE CHIP STAMPS, in the amount of Twenty-Nine Million Dollars ($29,000,000) and reference to said "Claims or Causes of Action" was thereafter repeatedly and unnecessarily made. Such constant reference to said claims was made with the intention to, and it did, cause the plaintiffs to be misled as to the true value of said shares. The Twenty-Nine Million Dollars ($29,000,000) amount of said claims was repeated and emphasized in said Negative Prospectus. Defendants knew that said claims were in fact of insignificant merit and were settled shortly after November 29, 1968, for less than One Million Dollars ($1,000,000.00).

(c) The "Litigation" section of the Negative Prospectus devotes three (3) printed pages to a recount of suits already settled with emphasis on the size of the claims, complexity of the matters, and a de-emphasis of the fact that they had already been settled. The Positive Prospectus one year later refers to none of these

cases by name and covers all of the settlements in two sentences.

(d) No underwriters were employed, no salesmen were used, and the offering was quietly accomplished by one mailing or hand delivery (unless the user filled out an information form requiring time and effort), and one newspaper advertisement in several California newspapers. Plaintiffs had no information as to the number of shares to which they were entitled unless they assembled data for defendants. However, defendants knew or should have known the number of shares each plaintiff was eligible to receive, but failed to disclose this information to plaintiffs.

(e) Plaintiffs were required to purchase their shares on or before November 29, 1968, or lose their rights.

(f) No information concerning the value of the stock was ever supplied to the plaintiffs by defendants except that set forth in the Negative Prospectus.

(g) The Negative Prospectus on Page 10 emphasized the possibility of losing customers and the obvious fact that defendant, BLUE CHIP STAMPS, had no assurance of continued patronage of its customers. The Negative Prospectus de-emphasized the fact that BLUE CHIP STAMPS' patronage undoubtedly would increase because it had been prohibited by the Consent Decree from preventing customers from giving extra stamps as a premium. BLUE CHIP STAMPS' business and profits did, in fact, increase substantially since the date of the Negative Prospectus.

(h) The Negative Prospectus on Page 12 states that the company estimates that Ninety-seven and one-half per cent (97½%) of all stamps issued will be redeemed. In fact, less than ninety per cent (90%) of all stamps

historically are redeemed. Based upon its sales of Ninety Million Dollars ($90,000,000.00) per year, or more, this misrepresentation resulted in an understatement of earnings on stamp sales for the year prior to the offering of Six Million Dollars ($6,000,000) or about eighty per cent (80%).

(i) The Negative Prospectus referred in several places to certain allegedly disadvantageous provisions of the Consent Decree or Plan in a negative manner designed to dissuade Users from exercising their rights under the said offering, and said Prospectus concealed from the Users, including plaintiffs, the fact that said Consent Decree would be highly beneficial to BLUE CHIP STAMPS in that its provisions were certain to, and did, force practically all competitors out of the State of California and that BLUE CHIP STAMPS and buyers of its Units would accordingly benefit thereby.

XV

The entire offering, as set forth in the Negative Prospectus, including but not limited to the provisions in said offering, as set forth in subparagraphs (a), (b), (c), (g), (h) and (i) of the last preceding paragraph of this pleading, resulted in the misrepresentation of material facts and the withholding of material information and was seriously misleading and was intended by defendants to be misleading in the light of all of the facts. The said offering did, in fact, mislead the plaintiffs in that they did not realize the real value of the Units being offered to them.

XVI

Relying upon said representations contained in the Prospectus, the plaintiffs, and each of them, were induced and did, in fact, not accept said offer and purchase said Units. Over 60% of the Users who purchased said Units had information outside and independent of said Negative Prospectus.

XVII

Under the said Consent Decree and The Plan, all of the members of the class suing herein, who failed to purchase said Units by reason of the facts set forth herein, were entitled to purchase the said Three Hundred Thousand (300,000) shares; that by not purchasing said shares at said price of Eight Dollars and Sixty-Seven Cents ($8.67) per share, they were damaged in the amount of Twenty-One Million Four Hundred Thousand Dollars ($21,400,000).

XVIII

Each of the defendants deliberately acted as hereinabove alleged for the purpose of benefiting themselves at the expense and to the damage of plaintiffs and each of them, and were thereby guilty of oppression, fraud and malice, whereby plaintiffs, and each of them, in addition to the actual damages hereinabove alleged, should recover damages for the sake of example and by way of punishing the defendants, and each of them.

SECOND CAUSE

I

Plaintiffs repeat and reallege each and all of the allegations of the First Cause with the same force and effect as if the same were here set forth in full.

II

The aforesaid misleading and false representations were made by defendants with the intent to induce plaintiffs to refrain from purchasing said offered shares of New Company in order that defendants would materially benefit from such failure of purchase on the part of prospective purchasers.

III

The aforesaid representations made by defendants were, at the time they were made and subsequent thereto, known to the defendants to be false and misleading.

IV

Plaintiffs, and each of them, at the time said representations were made and subsequent thereto, were ignorant of their false and misleading nature and believed them to be true and accurate. In reasonable reliance thereon, plaintiffs were induced to and did in fact refrain from accepting said offer; had plaintiffs known the true facts they would have accepted said offer and benefited from said "bargain sale."

V

By reason of said false and misleading representations by the defendants, and plaintiffs' reliance thereon, plaintiffs have been damaged in the amount of $21,400,000.

THIRD CAUSE

I

Plaintiffs repeat and reallege each and all of the allegations of their First Cause and Paragraph II of their

Second Cause with the same force and effect as if the same were here set forth in full.

II

When defendants made said false and misleading representations, they had no sufficient or reasonable ground for believing them to be true.

III

Plaintiffs, and each of them, at the time said representations were made and subsequent thereto, were ignorant of their false and misleading nature and believed them to be true and accurate. In reasonable reliance thereon, plaintiffs were induced to and did in fact refrain from accepting said offer; had plaintiffs known, the true facts they would have accepted said offer and benefited from said "bargain sale."

IV

By reason of said false and misleading representations by the defendants, and plaintiffs' reliance thereon, plaintiffs have been damaged in the amount of $21,400,000.

FOURTH CAUSE

I

Plaintiffs repeat and reallege each and every allegation of their First Cause with the same force and effect as if the same were here set forth in full.

II

The plaintiffs, and each of them, were the express intended beneficiaries of said final consent judgment entered into between the plaintiffs and defendants of [sic.] said prior proceedings and approved by the Court.

III

The aforesaid final consent judgment stated that defendants planned a reorganization of the BLUE CHIP STAMP COMPANY including a method of divestiture of defendants' holdings in said company which was to be conducted and effected in good faith by defendants.

IV

Defendants' aforesaid false and misleading misrepresentations were a violation of the Court imposed duty of good faith and constituted a breach of said Final Consent Judgment.

V

As a direct and proximate result of defendants' breach of said Final Consent Judgment, plaintiffs were damaged in the amount of Twenty-One Million Four Hundred Thousand ($21,400,000.00) Dollars.

WHEREFORE, plaintiffs pray judgment against the defendants as follows:

1. For damages in the amount of Twenty-One Million Four Hundred Thousand ($21,400,000.00) Dollars;

2. The right to purchase shares of stock or units of Blue Chip Stamps on the price and terms offered in the 1968 offering;

3. For exemplary damages in the amount of Twenty-Five Million ($25,000,000.00) Dollars;

4. For interest;

5. For attorneys' fees for the representation of plaintiffs herein;

6. For cost of suit; and

7. For all proper relief.

Dated January 26, 1971.

J. J. BRANDLIN, JAMES E. RYAN
and RAY E. MCALLISTER

By /s/ J. J. BRANDLIN

J. J. BRANDLIN

Jury trial requested.

J. J. BRANDLIN, JAMES E. RYAN
and RAY E. MCALLISTER

By /s/ J. J. BRANDLIN

J. J. BRANDLIN

[Exhibit "A" to First Amended Complaint]

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, *Plaintiff,* v. BLUE CHIP STAMP COMPANY; ALEXANDER'S MARKETS; LUCKY STORES, INC.; MARKET BASKET; PURITY STORES, INC.; RALPHS GROCERY COMPANY; SAFEWAY STORES, INCORPORATED; THRIFTIMART, INC.; THRIFTY DRUG STORES CO., INC.; and VON'S GROCERY CO. *Defendants.*	CIVIL ACTION NO. 63-1552-F ENTERED:

FINAL JUDGMENT

Plaintiff, United States of America, having filed its complaint in the United States District Court for the Southern District of California, Central Division, on December 26, 1963; each of the defendants having appeared and filed its answer denying the substantive allegations thereof; and the plaintiff and the defendants, by their attorneys, having severally consented to the entry of this Final Judgment without trial or adjudication of any issue of fact or law herein, without the taking of any evidence, and without this Final Judgment constituting any evidence or admission by any party in respect to any issue of fact or law herein;

NOW, THEREFORE, before the taking of any testimony and without trial or adjudication of any issue of fact or law herein and upon the consent of the parties hereto, it is hereby

ORDERED, ADJUDGED AND DECREED as follows:

I.

This Court has jurisdiction of the subject matter of this action and of the parties consenting hereto. The complaint states claims for relief against the defendants under Sections 1 and 2 of the Act of Congress of July 2, 1890, as amended, entitled "An Act to protect trade and commerce against unlawful restraint and monopolies," commonly known as the Sherman Act.

II.

For the purposes of this Final Judgment:

(A) "Person" shall mean an individual, partnership, firm, association, corporation or other legal or business entity;

(B) "Trading stamp business" shall mean the distribution for compensation, of trading stamps to any person for issuance to its customers, employees or others, and the redemption of said stamps for merchandise or money;

(C) "Trading stamp company" shall mean a person engaged in the trading stamp business;

(D) "Capital Assets" shall mean land, buildings, leasehold improvements, furniture and fixtures, warehouse equipment, delivery equipment and automobiles.

(E) "Southern California" is that part of California south of the line formed by the northern boundaries of San Luis Obispo, Kern and San Bernardino Counties.

(F) "New Blue Chip" shall mean a purchaser of, or any other successor to, Blue Chip's trading stamp business pursuant to Section VI herein or a reorganized company pursuant to Sections V or VII herein.

(G) "Reorganization" shall mean a reconstitution of the stock structure of Blue Chip and shall include the creation of a new company to which the assets and liabilities of Blue Chip are transferred, or into which Blue Chip is consolidated or merged.

III.

The provisions of this Final Judgment applicable to any defendant and any person agreeing to be bound shall also apply to each of its subsidiaries, successors, assigns, officers, directors, and employees, and to all other persons in active concert or participation with such defendant or persons who shall have received actual notice of this Final Judgment by personal service or otherwise, but shall not apply to transactions solely between or among such defendant or person and its officers, directors, employees, parent company, subsidiaries and affiliates, or any of them.

IV.

Each of the retailer defendants is enjoined and restrained from:

(A) Combining or conspiring to restrain trade in, or monopolizing or attempting to monopolize the trad-

ing stamp business in the State of California; or carrying out, directly or indirectly, any such combination, conspiracy, attempt to monopolize or monopolization;

(B) Entering into any contract, agreement or understanding with any other user of trading stamps in the same line of business:

(i) To refrain, in the State of California or in particular areas thereof, from using trading stamp services entirely or from using the trading stamp services of any particular person or persons; or

(ii) To limit the rate of issue employed in distributing trading stamps to their respective customers in such state;

(C) Acting jointly with any other user of trading stamp services in the same line of business to organize or acquire a trading stamp company to operate in the State of California except as provided in Sections V, VI or VII hereof.

Provided, that this Section IV shall not apply to a retailer defendant, acting independently: (i) in obtaining or entering into any contract to obtain trading stamp services from any trading stamp company; or (ii) when such defendant is engaged in the trading stamp business (either directly or through a subsidiary or affiliate), in furnishing or entering into any contract to furnish trading stamp services to any person, and provided further that this Secion IV shall not apply to the provision of trading stamp services by any trading stamp company which is not named as a defendant herein.

V.

Blue Chip is ordered and directed to present to the Court, within 60 days following the date of entry of this Final Judgment, a plan for the reorganization of Blue Chip Stamp Company. The plan shall be substantially in accordance with either of the plans heretofore furnished to plaintiff. Upon approval of the plan by the Court, Blue Chip shall make bona fide and diligent efforts to reorganize the company pursuant to the said plan. If at any time, in plaintiff's judgment, such efforts are not being made, plaintiff may apply to the Court for an order directing that this Section V shall no longer apply. In the event that such order issues, Blue Chip shall be required to divest pursuant to Section VI or to reorganize pursuant to Section VII hereof.

VI.

(A) In the event that Section V becomes inapplicable Blue Chip is ordered and directed to divest, with all due diligence, within 15 months from the date upon which Section V shall no longer apply, all of the company's capital assets, goodwill, and the right to the service mark and to the use of the name "Blue Chip," and, following such divestiture, to discontinue issuance of trading stamps, cease doing business as on operating company and thereafter to wind up its affairs and dissolve consistent with the applicable laws of the State of California.

The divestiture shall be made upon the following terms and conditions:

(1) The purchaser or successor to Blue Chip's trading stamp business shall agree to enter its appearance in this proceeding and shall furnish its written consent

to be bound by the applicable provisions of this Final Judgment.

(2) The purchaser or successor shall agree to engage in the trading stamp business in California for a reasonable period of time.

(3) The purchaser or successor shall contract with Blue Chip on mutually satisfactory terms for the redemption of all outstanding trading stamps theretofore issued by Blue Chip and said contract shall insure discharge of Blue Chip's redemption obligations and shall require the purchaser or successor to redeem its stamps interchangeably with the trading stamps theretofore issued by Blue Chip.

(4) The purchaser or successor shall assume such other obligations as Blue Chip and it may agree and Blue Chip shall transfer such cash, securities or other assets as it and Blue Chip may agree.

The said divestiture may be made by a sale of assets, a sale of stock of a corporation which controls the assets, or in any other manner not otherwise inconsistent with the terms of this decree. Provided, that in the event that all of the stockholders of Blue Chip dispose of their stock to a purchaser or successor said disposal shall be regarded as a divestiture by Blue Chip for the purposes of this Final Judgment.

(B) Blue Chip shall make known the availability of the assets for sale. Blue Chip shall furnish to bona fide prospective purchasers making inquiry to it, such information as is reasonably necessary for them to proceed with negotiations looking toward the ultimate acquisition of the assets to be divested and shall furnish plaintiff concurrently with the name of any such prospective purchaser. Blue Chip shall render quarterly reports to the

Assistant Attorney General in charge of the Antitrust Division concerning its efforts to effectuate the divestiture required, the first such report to be rendered within 30 days of the date that Section V shall no longer apply.

(C) At least 30 days in advance of the closing date specified in any contract for sale, Blue Chip shall supply plaintiff with the name of the proposed purchaser, the purchase contract, and with such other information in its possession as is material to the proposed sale. If plaintiff requests, the said closing date shall be extended to the extent necessary to afford plaintiff 60 days between the date of the receipt of the said information and the closing date. Blue Chip may close any sale unless plaintiff serves upon Blue Chip, at least 15 days in advance of the closing date, written notice that plaintiff objects thereto. If plaintiff serves such written notice with respect to a sale to a purchaser engaged in the trading stamp business, or a purchaser engaged in the operation of retail food stores in the State of California, such sale shall not be closed. If plaintiff serves such written notice with respect to any other sale, the sale shall not be closed unless approved by the Court. The time period set forth in Section VI(A) above shall be tolled during the pendency of any extension or of any proceeding under this Section VI(C).

(D) The divestiture ordered and directed by Section VI(A) of this Final Judgment shall be made in good faith and shall be absolute and unqualified except as follows:

(1) Nothing herein contained shall be deemed to prohibit Blue Chip from retaining, accepting and enforcing a bona fide lien, mortgage, deed of trust or any other form of security reasonably necessary to secure full payment of the price at which the divested property

is disposed of or sold or to secure any other obligation of a purchaser or successor, provided that if Blue Chip shall regain ownership of or control over the property divested as a result of any lien, mortgage, deed of trust, or other undertaking Blue Chip shall be required to terminate such ownership or control within 18 months thereafter.

(2) In the event that Blue Chip receives, as a result of any divestiture hereunder, stock of a corporation which controls the divested assets:

(a) Blue Chip shall be required: (i) to dispose of any amount of such stock in excess of 10% of the outstanding common stock of such corporation within one year following the date of receipt thereof or within 22 months following the date Section V shall no longer apply, whichever is earlier, provided that in no event shall such disposal be required within less than three months following the date of receipt of such excess; and (ii) to dispose of the balance of such stock no later than the date of final distribution in liquidation; and (iii) pending disposal, to cause any voting rights of such stock to be exercised by a financial institution or other third party who is acceptable to plaintiff or approved by the Court; and

(b) In the event Blue Chip distributes such stock to its shareholders, no distribution shall be made pursuant to which any Blue Chip shareholder will retain more than 1% of the outstanding common stock of the said corporation unless the plan of distribution is acceptable to plaintiff or approved by the Court.

VII.

In the event that Section V becomes inapplicable, Blue Chip may also enter into a reorganization pursuant to a plan for the reorganization of Blue Chip Stamp Company acceptable to the Court. The plan shall be substantially in accordance with either of the plans heretofore furnished to plaintiff or in accordance with any other plan acceptable to Blue Chip and to plaintiff.

VIII.

(A) Blue Chip is ordered and directed to continue its trading stamp business and to continue to promote its trading stamp service until completion of the reorganization set forth in Sections V or VII above or until the divestiture set forth in Section VI above. Until such reorganization or divestiture Blue Chip is enjoined and restrained from:

(1) Refusing to provide a trading stamp service or imposing any limitation on such service to any person because of: (i) the presence in the same locality of any establishment operated by another person using Blue Chip's stamp service; (ii) the rate of issue employed by such person in offering Blue Chip's or any other person's stamps; or (iii) the use by such person of any other trading stamp service;

(2) Coercing or compelling any person: (i) to limit the rate of issue employed in offering Blue Chip's or any other person's stamps; or (ii) to refrain from using any other trading stamp service.

(B) New Blue Chip, in the event that it is not already a party hereto, shall enter its appearance in this proceeding and give its consent to be bound by the applicable provisons of this Final Judgment. A purchaser of assets

pursuant to Section IX hereof shall enter its appearance in this proceeding and give its consent to be bound by the applicable provisions of this Final Judgment. New Blue Chip and such purchaser are enjoined and restrained from:

(1) Refusing to provide a trading stamp service or imposing any limitation on such service to any person because of: (i) the presence in the same locality of any establishment operated by another person using the company's stamp service; (ii) the rate of issue employed by such person in offering the company's or any other person's stamps; or (iii) the use by such person of any other trading stamp service;

(2) Coercing or compelling any person (i) to limit the rate of issue employed in offering the company's or any other person's stamps; or (ii) to refrain from using any other trading stamp service;

(3) Having as an officer or employee any person who, while holding such position, also serves as an officer, director, or employee of any person using trading stamp services; or from having, for a period of ten years following the date of entry of this Final Judgment, as a director, any person who, while holding such position, also serves as an officer, director or employee of any person who was a Blue Chip stockholder in 1956 or 1957.

(C) Each of the retailer defendants is enjoined and restrained for a period of ten years following the date of entry of this Final Judgment:

(1) From having as an officer, director, or employee any person who, while holding such position, also serves as an officer, director or employee of New Blue Chip; or

(2) From exercising any right which it might acquire to vote for the election of any official of New Blue Chip; *provided* that a retailer defendant may cause such right to be exercised independently by a financial institution or other third party acceptable to plaintiff or approved by the Court.

Each retailer defendant shall be free to utilize or not utilize the trading stamp services of Blue Chip and New Blue Chip and, except as provided in this Section VIII(C), to exercise the same rights and privileges available to every other user of the stamp services of Blue Chip or New Blue Chip.

IX.

New Blue Chip shall, within 30 months after the date of completion of the reorganization under Sections V or VII above or the divestiture under Section VI above present for the approval of the Court a plan which shall include the following terms:

(1) New Blue Chip shall offer for sale one-third of its then existing trading stamp business in the State of California. The business to be offered for sale shall be located within a contiguous geographic area within Southern California.

(2) A purchaser shall be permitted to acquire the business only upon the condition that it enter its appearance in this proceeding and agree: (i) to be bound by the applicable provisions of Sections VIII(B), IX, X and XI of this Final Judgment and (ii) to engage in the trading stamp business for a reasonable period of time. A purchaser shall have the right, if it so elects, to redeem New Blue Chip trading stamps within the contiguous area for the period of one year following

the consummation of the sale. Plaintiff shall have the right to object to a purchaser in the same manner as it may object to a purchaser under Section VI(C) above.

(3) New Blue Chip shall not, during the period of one year following the consummation of the sale: (i) knowingly allow any person operating retail establishments in the contiguous area to issue New Blue Chip stamps to customers of such establishments; or (ii) furnish New Blue Chip stamps to any person with knowledge that the stamps will be issued to customers at any retail establishment in the contiguous area; or (iii) otherwise engage in the trading stamp business in the contiguous area except that, if the purchaser does not elect to redeem New Blue Chip stamps or if the purchaser fails to perform in accordance with his redemption obligations, New Blue Chip shall have the right to redeem its outstanding stamps in said area. Following the said one year period, New Blue Chip shall offer its trading stamp service in the contiguous area.

X.

For the purpose of securing compliance with this Judgment and for no other purpose:

(A) Any duly authorized representative or representatives of the Department of Justice shall, upon written request by the Attorney General or the Assistant Attorney General in charge of the Antitrust Division and on reasonable notice to any defendant, New Blue Chip, or any purchaser under Section IX hereof, made to its principal office, and subject to any legally recognized privilege, be permitted:

(1) Access during the office hours to all books, ledgers, accounts, correspondence, memoranda, and other records and documents in the possession or under

the control of any person specified in this Section X(A) related to any matters contained in this Judgment;

(2) Subject to the reasonable convenience of, and without restraint or interference from, any person specified in this Section X(A), to interview officers or employees of any such person who may have counsel present, regarding any such matters.

(B) Upon written request of the Attorney General or the Assistant Attorney General in charge of the Antitrust Division, any defendant, New Blue Chip or a purchaser under Section IX shall submit such additional reports in writing with respect to the matters contained in this Final Judgment as may be requested. Provided that no information obtained by the means provided for in this Section X shall be divulged by any representative of the Department of Justice to any person other than a duly authorized representative of the Executive Branch of the United States, except in the course of legal proceedings to which the United States is a party for the purpose of securing compliance with this Final Judgment or as otherwise required by law.

XI.

Jurisdiction is retained for the purpose of enabling any of the parties to this Final Judgment to apply to this Court at any time for such further orders and direction as may be necessary or appropriate for construction, carrying out, modification, termination or enforcement of or compliance with the provisions of this Final Judgment and for the punishment of violations thereof.

Dated: June 5, 1967

_____

United States District Judge

[Exhibit "B" to First Amended Complaint]

O'MELVENY & MYERS
433 South Spring Street
Los Angeles, California 90013
620-1120
Attorneys for Certain Defendants

[Filed October 13, 1967]

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, *Plaintiff,* vs. BLUE CHIP STAMP COMPANY; ALEXANDER'S MARKETS; LUCKY STORES, INC.; MARKET BASKET; PURITY STORES, INC.; RALPHS GROCERY COMPANY; SAFEWAY STORES, INCORPORATED; THRIFTIMART, INC.; THRIFTY DRUG STORES CO., INC.; and VON'S GROCERY CO., *Defendants.*	CIVIL ACTION NO. 63-1552-F REVISED ORDER APPROVING PLAN OF REORGANIZATION WITH CERTAIN CONDITIONS

The defendants having lodged with the Court on August 3, 1967 a Plan of Reorganization (copy of which is attached hereto as Exhibit A) pursuant to Paragraph V of the Final Judgment entered herein on June 5, 1967, and the matter having come before the Court on defendants' motion for approval of the said Plan of

Reorganization, which said motion was noticed for hearing on August 21, 1967 and thereafter continued to August 29, 1967, and notice of said hearing and of the continuance thereof having been given to the parties hereto and to the attorneys for the various persons who have appeared in this matter as amicus curiae or otherwise, and the Court, having heard the arguments and considered the same, and having determined that the said Plan of Reorganization is substantially in accordance with "Reorganization Plan 'B' For Blue Chip Stamp Company" lodged with this Court on April 28, 1967 and filed June 5, 1967, now Orders as follows:

1. The Court finds that the said Plan of Reorganization of Blue Chip Stamp Company is substantially in accordance with Reorganization Plan "B" for Blue Chip Stamp Company lodged on April 28, 1967 and filed June 5, 1967.

2. The Court approves the said Plan of Reorganization subject to the following conditions:

(a) Except to the extent that restraints are imposed on the retailer defendants by the Final Judgment or the Plan of Reorganization with respect to the purchase of additional shares by any of them, or are imposed by the purchase agreements with management employees or by the Securities Act of 1933 on shares to be subject to a qualified stock option plan, there shall be no restraint upon free alienation of any of the shares to be issued.

To enable the retailer defendants and the other present stockholders of Blue Chip Stamp Company to sell any or all of their shares in compliance with the Securities Act of 1933, New Company shall register under that Act the shares of such stockholders at such time or times as may be requested by any of

them, but in no event shall New Company be obligated to so register more than one time in any calendar year. New Company shall not be obligated to pay any of the expenses of such registrations nor to keep any registration referred to in this subsection (a) effective for longer than six months; provided, however, that New Company shall be obligated to pay expenses (other than underwriting fees) for one registration if the request for the same shall have been made during the three months period commencing January 1, 1969 and for one additional registration if the request for the same shall have been made during the three months period commencing January 1, 1970. Within ten days of receipt of any written request from such a stockholder to register its shares, New Company shall give notice thereof to all other of said stockholders and offer them an opportunity to join in the registration so requested. The Company shall file such Registration Statement with the Securities and Exchange Commission on or before May 31 of that year.

With the exception of the two registrations which may be requested in the two three-month periods referred to above, all expenses, direct and indirect, of registrations, if any, requested by such a stockholder or stockholders shall be paid for by it or them, and within ten days of receipt of such a written request from such a stockholder to register its shares, New Company shall give notice thereof to all other such stockholders and offer them an opportunity to join in and share the expense of the registration so requested.

If at any time prior to June 5, 1977, as a result of purchases by New Company of its shares, the aggregate of shares beneficially owned by the retailer defendants exceeds 43% of (a) the Company's outstand-

ing shares and (b) the Company's shares reserved for issuance pursuant to a qualified stock option plan, the Company shall present to the Court within 60 days a plan for disposing of a number of shares sufficient to reduce the percentage of shares beneficially owned by the retailer defendants below such 43%.

(b) Within 60 days after the election of the Permanent Directors of the New Company, the New Company shall present to the Court a plan for the disposition of all unsubscribed shares.

(c) Approval of the Plan of Reorganization does not constitute a finding or any expression of opinion with respect to California law, or as to whether the provisions of said Plan with respect to indemnification are or will be valid or enforceable.

DATED: October 13, 1967.

/s/ WARREN J. FERGUSON
United States District Judge

APPROVED AS TO FORM:

STANLEY E. DISNEY
LAWRENCE W. SOMERVILLE

By /s/ STANLEY E. DISNEY
Stanley E. Disney
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Attorneys for Certain Defendants

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, *Plaintiff,* v. BLUE CHIP STAMP COMPANY; ALEXANDER'S MARKETS; LUCKY STORES, INC.; MARKET BASKET; PURITY STORES, INC.; RALPHS GROCERY COMPANY; SAFEWAY STORES, INCORPORATED; THRIFTIMART, INC.; THRIFTY DRUG STORES CO., INC.; and VON'S GROCERY CO., *Defendants.*	CIVIL ACTION NO. 63-1552-F PLAN OF REORGANIZATION OF BLUE CHIP STAMP COMPANY SUBMITTED PURSUANT TO SECTION V OF FINAL JUDGMENT ENTERED JUNE 5, 1967

I.

GENERAL STATEMENT OF PLAN OF REORGANIZATION

Pursuant to the decree entered by the United States District Court (the "Court") on June 5, 1967 (the "Decree"), Blue Chip Stamp Company, a California corpora-

tion ("Blue Chip"), has developed the plan of reorganization hereinafter set forth (herein the "Plan").

The Plan contemplates the formation of a new California corporation (herein "New Company") with an authorized capitalization of 1,400,000 shares of Common Stock, par value 33⅓ cents per share, the issuance of a single share of its stock for cash to Blue Chip, the merger of Blue Chip into it with the result that each holder of Blue Chip stock shall receive 1,200 shares of the Common Stock of New Company for each Blue Chip share held (of whichever class). This will result in there being outstanding (assuming no Blue Chip shareholders dissent) 621,600 shares of New Company, all owned by the present shareholders of Blue Chip. Prior to the merger the stockholders of Blue Chip will make a capital contribution in the aggregate amount of $155,400 in cash to Blue Chip. An offering of approximately 621,600 shares of its Common Stock will then be made by New Company to users of Blue Chip stamps (who issue stamps to their retail customers as a reward for patronage) other than users who are also shareholders of Blue Chip (such users to whom such offering is to be made are hereinafter referred to as "Users") on a prorata basis determined by the quantity of stamp pads issued to Users during the period subsequent to March 1, 1964 and prior to a date to be determined which will be not more than 90 days prior to the effective date of the registration statement hereinafter referred to. The offering will be made in units consisting of three shares of the Common Stock of New Company and one $100 principal amount debenture for a cash consideration of $101. New Company will also adopt a qualified stock option plan and will grant options pursuant thereto to key employees covering an aggregate of 110,400 shares of its Common Stock. New Company will also offer to sell 27,600 shares to key executive em-

ployees at a price of 33⅓ cents per share. The steps taken pursuant to the Plan will be substantially in accordance with those set forth in Sections II and III below.

II.

VARIOUS STEPS OF THE PLAN

A. Formation of New Company.

A California corporation will be formed with an authorized capitalizaton of 1,400,000 shares of Common Stock of the par value of 33⅓ cents per share. The articles of incorporation will provide for three incorporators who will be the first directors.

After the filing of the articles of incorporation with the Secretary of State of the State of California, the incorporators will hold an organization meeting adopting by-laws, stock certificates, seal, providing for a principal office and various other ministerial matters. In addition the first directors will authorize the filing of an application for permit with the Commissioner of Corporations of the State of California (the "Commissioner") to permit the sale and issuance of one share of its stock to Blue Chip and the sale of such share in accordance therewith. Temporary officers will be elected.

The application for permit will be filed with the Commissioner and a permit obtained as promptly as possible thereafter. A share will then be sold to Blue Chip for $1. Blue Chip, as the sole shareholder of New Company, will then amend the by-laws to provide for a board of 11 directors. Immediately thereafter the first directors will tender their resignations and elect 11 temporary directors, all of whom will be the present directors of Blue Chip. The first directors will also elect as officers of New Com-

pany the present officers of Blue Chip, each holding the respective office that he holds in Blue Chip. Following the close of the subscription offering to Users, there shall be a meeting of the shareholders of New Company for the purpose of electing a new board of directors (the "Permanent Directors").

B. Merger of Blue Chip into New Company.

After the first share of New Company is issued, Blue Chip and New Company will enter into an agreement of merger which will provide for the issuance, upon the merger, of 1,200 shares of the Common Stock of New Company for each share of Blue Chip of either class then outstanding. New Company will, expressly, and by operation of law under the California statutes governing statutory mergers, acquire all the assets of Blue Chip. In consideration for such transfer of assets, New Company will assume all liabilities of Blue Chip arising out of its organization and operations prior to the date the Decree becomes final and not subject to appeal, including, without limitation, those existing by virtue of antitrust claims against Blue Chip, its past and present officers, directors and shareholders, by virtue of Blue Chip's organization and operations and liabilities of Blue Chip, its officers, directors and shareholders arising from carrying out this plan of reorganization. A special shareholders' meeting of Blue Chip will be called and noticed, which notice shall be accompanied by a statement of the terms of the proposed merger and also of the contemplated offering to management personnel and to Users. The special meeting of Blue Chip shareholders will be held approving the merger and, concurrently with this meeting Blue Chip, as the sole shareholder of New Company, will approve the merger by written consent. Notice will then be mailed to all shareholders of both corporations of the approval

of the merger, thus starting the statutory period within which a dissenter may give notice of his dissent.

Immediately prior to the effectiveness of the registration statement concerning the offering to Users, the merger agreement will be filed with the Secretary of State of the State of California, thus effecting the merger. Each of such defendants shall, prior to the shareholder meeting for the election of Permanent Directors, deliver its shares to a separate and independent trustee acceptable to the Department of Justice or the Court. Such defendants may sell any of their shares at any time, but are prohibited from purchasing any additional shares for a period of ten years.

C. Offering to Users.

1. California Commissioner of Corporations.

New Company will file an application with the Commissioner of Corporations of the State of California for a permit authorizing it to sell, in accordance with the terms of offering set forth below, to the Users units consisting of three shares of its Common Stock combined with one $100 principal amount debenture for a cash price of $101.

2. Securities and Exchange Commission.

New Company will prepare and file a registration statement on Form S-1 under the Securities Act of 1933 with the Securities and Exchange Commission (the "SEC") covering the offering to Users. It is contemplated that there will be a prefiling conference with the SEC and a request for expeditious examination of the registration statement and the issuance of a letter of comments thereon. As soon as practicable after the comments are received, an appropriate amendment or amendments to the registration statement will be filed in response

thereto. The registration statement relating to the offering will be declared effective and the indenture, pursuant to which the debentures will be issued, will be qualified under the Trust Indenture Act of 1939.

3. The Units.

Each unit shall consist of three shares of the Common Stock of New Company and one $100 principal amount debenture. The debentures shall mature ten years after their date, shall bear interest, payable quarterly, at 6% or at one-half per cent above the prime rate in effect in Los Angeles on the date the registration statement is initially filed with the Securities and Exchange Commission, whichever is higher, shall be subordinated to claims or causes of action, including, without limitation, claims under the antitrust laws, aganst Blue Chip and its past and present officers, directors and stockholders relating to Blue Chip operations prior to the date the Decree becomes final and not subject to appeal, or arising from the reorganization covered by this Plan, may be paid (in whole or in part) without penalty at any time after six years after their date, and will be entitled, after provisions for subordination, to mandatory sinking fund payments equal to 20% of the aggregate principal amount outstanding on the sixth anniversary of their date of issuance on such date and on the seventh, eighth and ninth such anniversary dates. The debentures will be issued pursuant to an indenture which will be qualified under the Trust Indenture Act of 1939 and will contain other usual provisions.

4. Offer to Users.

As soon as the registration statement has been declared effective by the SEC: each past User whose name appears on Blue Chip Records as a "house account"

during the period subsequent to March 1, 1964 and prior to a date to be determined which will be not more than 90 days prior to the effective date of the registration statement referred to above, and each current user, will have mailed to its latest address according to the records of Blue Chip a copy of the prospectus, together with a notice that such Users will be offered the opportunity to purchase units after their respective entitlements have been ascertained.

Advertisements will also be placed in appropriate newspapers advertising that an offering of units will be made to the Users of stamps subsequent to March 1, 1964 and advising that any of such Users who have not been sent the mailing by the Company referred to above may request a copy of the prospectus and a form on which such User may establish his usage since March 1, 1964 for the purpose of participating in the offering. Thirty days after the publication of the first such advertisement, the right of Users to establish their usage shall terminate.

Immediately thereafter New Company shall commence the preparation of a list of all Users who have been sent the mailing referred to above and those who have responded to the advertisement and have established their eligibility as Users. Such list shall show, with respect to each User, the number of units to which such User is entitled, determined as set forth below. As soon as practical thereafter there shall be mailed to all such Users a subscription form on which will be stated the maximum number of units that the respective User is entitled to purchase. The subscription form shall state that the User may purchase any lesser number of units. Such subscription rights shall not be transferable and the securities constituting the Units purchased will be issued only in the name of the User.

For a period of 30 days after all subscription forms are mailed out, each User may complete the form agreeing to buy the number of units (up to the stated maximum) which he sets forth thereon and send the form, together with a check covering the purchase price of such units, to the Subscription Agent, which shall be a bank located in Los Angeles, California. Such subscription offer shall terminate at the close of business on the thirtieth day after the mailing of the subscription form. New Company shall instruct the Subscription Agent to issue securities comprising the units purchased and send them to the purchasers thereof, all in accordance with the terms of the offer, provided that no units shall be issued until the check representing the purchase price has cleared.

5. Method of Determining User's Entitlement to Units.

The number of units which each User shall be entitled to purchase shall be determined as follows: 207,200 units (the total number of units to be offered) will be available to all nonstockholder users during the period between March 1, 1964 and a date to be determined which will be not more than 90 days prior to the effective date of the registration statement referred to above. Each eligible User will be entitled to units as its total use during such period bears to the total use by all nonstockholder users during such period, with a minimum of one unit. No fractional units shall be issued. The number of units to which any User is entitled shall be rounded to the nearest whole unit (with all Users being entitled to a minimum of one Unit), and those entitled to an even one-half unit shall be rounded to the next higher full unit.

D. Offering to Management and Qualified Stock Option Plan.

1. California Commissioner of Corporations.

New Company will file an application with the Commissioner of Corporations of the State of California for a permit authorizing it to sell 27,600 shares of its Common Stock to management employees at a price of 33⅓ cents per share. It will concurrently apply for the permit of the Commissioner authorizing the grant of options pursuant to the qualified stock option plan and the issuance of shares pursuant thereto.

2. Terms of Offering to Management.

The shares to management employees will be sold immediately after the merger under a separate purchase agreement with each employee which will provide, among other things, that the shares subject thereto cannot be sold, transferred or hypothecated by the purchaser for a specified period of time and that during such period of time if such employee voluntarily (as defined in the agreement) terminates his employment with New Company or attempts to sell his stock in violation of the agreement, New Company shall have the right to buy such shares at the price which he paid for them. Such restrictions and the resale obligation will terminate with respect to 20% of each management employee's shares in each of five consecutive years, with all such restrictions and obligations being terminated not later than January 1, 1974.

3. Terms of the Qualified Stock Option Plan.

The qualified stock option plan will be adopted by the directors of New Company and approved by its shareholders immediately following the merger. The qualified stock option plan will cover 110,400 shares of New Com-

pany Common Stock, will provide for the grant of options thereon at not less than the fair market value of the shares on the date of grant, the options granted will be exercisable in installments of 25% thereof at the end of each of the first, second, third and fourth years after the date of grant, the person acquiring the shares on exercise of the option will give an investment letter with respect thereto (unless the stock is registered under the Securities Act of 1933), and the options shall not be transferable, except to a limited extent upon the death of an optionee. The options will terminate not more than five years after the date of grant. It is contemplated that the option plan will contain provisions which are standard in such plans.

E. Compliance with Decree by New Company.

Blue Chip and New Company (as Blue Chip's successor under Section III of the Decree) will conduct the operations of the trading stamp business in accordance with the provisions of Section VIII(A) of the Decree. New Company will be regarded as "New Blue Chip" under the Decree upon the election of the Permanent Directors of New Company. The Permanent Directors will authorize and cause New Blue Chip to enter its appearance in *United States v. Blue Chip Stamp Company, et al.* and to give the required consent pursuant to the provisions of Section VIII(B) of the Decree. At that point New Blue Chip will become bound by the provisions of Section VIII(B) of the Decree; New Blue Chip will engage in the trading stamp business for a reasonable period of time thereafter; and New Blue Chip and the stockholder defendants will thereafter be precluded from having common officers, directors and employees. (See Sections VIII(B) and (C) of the Decree.) As is indicated above, prior to the shareholder meeting for the election of Permanent Directors the stockholder defendants will have placed their stock

in trust so that the voting rights of the shares of each of the stockholder defendants may be exercised only by persons acceptable to the Department of Justice or to the Court.

F. Disposition of Unsubscribed Shares, If Any.

Based upon the outcome of the offering to Users and employees, the Permanent Directors will take such steps as may be necessary to complete the reorganization by obtaining an appropriate disposition of any unsubscribed shares.

III.

PRINCIPAL ACTIONS

The following sets forth a summary of specific steps contemplated for effecting the Plan. New Company will try to complete the action necessary in connection with carrying out the Plan as expeditiously as is reasonably practicable. Certain events are dependent upon action by other persons or entities and the speed with which such action will be taken will not always be within the control of New Company.

1. Incorporate New Company.

2. File application with Commissioner of Corporations of the State of California (the "Commissioner") for a permit authorizing the issuance of one share of New Company to Blue Chip.

3. File application with the Commissioner for a negotiating permit authorizing the signing of the merger agreement.

4. Obtain permit.

5. Boards of directors of Blue Chip and New Company approve merger.

6. Send notice of special meeting of stockholders and proxy statement to shareholders of Blue Chip.

7. File application with the Commissioner for a definitive permit authorizing the merger and the issuance of shares.

8. File registration statement with the SEC under the Securities Act of 1933 to register the units to be offered to Users.

9. File application with the Commissioner for a permit authorizing the offering to Users, and sale of shares to management employees and the grant of options under the qualified stock option plan and the sale of shares pursuant thereto.

10. Hold special meeting of stockholders of Blue Chip to approve merger; stockholder of New Company consents to merger.

11. Send notice to shareholders of Blue Chip advising as to approval of merger.

12. Take any other necessary action with respect to blue sky or securities laws of any other states in which the offering will be made.

13. Receive comments on the registration statement from the SEC.

14. File the first amendment to the registration statement with the SEC.

15. File a second amendment to the registration statement, if necessary, with the SEC.

16. Obtain permit authorizing the merger and the offering of units, shares and options from the Commissioner.

17. File agreement of merger with the Secretary of State of the State of California effecting merger.

18. Hold meeting of New Company stockholders to adopt qualified stock option plan.

19. Registration statement declared effective.

20. Sell shares to management employees.

21. Mail copy of prospectus to all known Users, together with advice that offering will be forthcoming.

22. Make a public solicitation for information concerning other Users who would be entitled to participate in the offering.

23. Right of Users to prove their entitlement to units or to indicate their interest in participating terminates.

24. Send subscription forms to Users entitled to participate in the offering advising as to the number of units to which the User is entitled.

25. Subscription period ends.

26. Complete issue of units to those purchasing them.

27. Select trustees to hold shares and obtain necessary approval thereof.

28. Hold meeting of shareholders to elect Permanent Directors.

29. Authorize and enter appearance of New Blue Chip.

SUPREME COURT, U. S.
OCT 15 1974
MICHAEL RODAK, JR., CLE

No. 74-124

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1974

Blue Chip Stamps, et al.,

Petitioners,

v.

MANOR DRUG STORES, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps

Respondent.

OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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TOPICAL INDEX

	Page
Table of Authorities	iii
OPINIONS BELOW	2
QUESTIONS PRESENTED	2
STATUTORY PROVISIONS	3
STATEMENT OF THE CASE	5
1. Relevant Facts Preceding the Filing of This Action	6
2. Allegations of The Complaint	15
ARGUMENT	22
1. Do Section 10(b) Of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 of the Securities And Exchange Commission Deny Standing in a Civil Damage Action to a Plaintiff Who Has a Right Or Entitlement To Purchase Securities But Is Deprived Of Exercising Said Right Or Entitlement Because Of The Fraud Of Title Offeror?	22-23
2. The Decision Below Does Not Deal With The Question Of Whether An Amicus Curiae May Enforce A Consent Decree, Nor With The Policy And Intent Of The Securities Act of 1933	40
CONCLUSION	47

Page

SUMMARY OF ARGUMENT 48

APPENDIX A

Plaintiff-Appellant's
Supplemental Brief
filed August 15, 1972
No. 71-2223

TABLE OF AUTHORITIES

Cases	Page
A. T. Brod. & Co. v. Perlow, 375 F.2d 393 (2nd Cir. 1967)	26
Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2nd Cir. 1952) cert. denied, 343 U.S. 956, 96 L.Ed.2d 1356, 72 S.Ct. 1051 (1952)	24, 28, 29, 30, 35, 36
Coffee v. Permian Corp., 434 F.2d 383 (5th Cir. 1970)	26
Crane Company v. Westinghouse Air Brake Co., 419 F.2d 787 (2nd Cir. 1969)	34
Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir. 1967)	25, 26
Data Proc. Fin. & Gen. Corp. v. International Bus. Mach. Corp., 430 F.2d 1277 (8th Cir. 1970)	43
Eason v. General Motors Acceptance Corp., 490 F.2d 654 (7th Cir. 1973)	27, 35, 36, 37, 39

Cases	Page
Erling v. Powell, 429 F.2d 795 (1970)	32
Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N.D. Ill. 1967)	26
Haberman v. Murchison, 468 F.2d 1305 (2nd Cir. 1972)	34
Hooper v. Mountain States Securities Corp., 282 F.2d 195 (5th Cir. 1960) cert. denied, 365 U.S. 814 (1961)	26
James v. Gerber Products Co., 483 F.2d 944 (1973)	30
Landy v. Federal Deposit Insurance Corp., 486 F.2d 139 (3rd Cir. 1973)	30
Mader v. Armel, 402 F.2d 158 (6th Cir. 1968) cert. denied, 394 U.S. 940 (1969)	26
Ruckle v. Roto American Corp., 339 F.2d 24 (2nd Cir. 1964)	26
Sargent v. Genesco, 492 F.2d 750 (5th Cir. 1974)	30, 31

Cases	Page
Schoenbaum v. Firstbrook, 405 F.2d 215 (2nd Cir. 1968) cert. denied, 395 U.S. 906 (1969)	26
Simmons v. Wolfson, 428 F.2d 455 (1970)	29
Stockwell v. Reynolds & Co., 252 F. Supp. 215 (S.D. N.Y. 1956)	27, 33
Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971)	27, 29
Travis v. Anthes Imperial Limited, 473 F.2d 515 (1973)	33
United States v. Armour & Co., 402 U.S. 673 (1971)	40, 41, 42
Vine v. Beneficial Financial Company, 374 F.2d 627, cert. denied, 389 U.S. 970 (1970)	25

Statutes

Securities Exchange Act of 1933	
15 U.S.C. §77a et seq.	24, 40, 45, 47
15 U.S.C. §78a, et seq.	24

Statutes	Page
Securities Exchange Act of 1934	
15 U.S.C. 78j(b)	2, 3, 6, 22
Regulations	
17 C.F.R. §240.10b-5	4, 6
Rules	
Securities Exchange Commission	
Rule 10b-5	2, 4, 6, 22

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Respondent.

OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Respondent files this opposing brief under Supreme Court Rule 24 and prays that this Court deny the Petition for Writ of Certiorari to review the decision of the United States Court of Appeals for the Ninth Circuit, which reversed a decision

of the United States District Court for the Central District of California dismissing Respondent's First Amended Complaint.

OPINIONS BELOW

The opinion of the court of appeals, as modified, is reported at 492 F. 2d 136 and appended to the petition as Appendix A. The order denying petitions for a rehearing in banc before the Ninth Circuit with certain modifications of the court of appeals opinion is set forth in Appendix B to the petition. The decision of the district court is found at 339 F. Supp. 35 and in Appendix C of the petition.

QUESTIONS PRESENTED

1. Do Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 of the Securities and Exchange Commission deny standing in a civil damage action to a plaintiff who has a right or entitlement to purchase

securities but is deprived of exercising said right or entitlement because of the fraud of the offeror?

2. The decision below does not deal with the question of whether an amicus curiae may enforce a Consent Decree, nor with the policy and intent of the Securities Act of 1933.

STATUTORY PROVISIONS

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), provides in pertinent part:

> "§ 78j. Manipulative and deceptive devices
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, of any facility of any national securities exchange--

". . . .

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated by the Securities and Exchange Commission, provides as follows:

"§ 240.10b-5 Employment of manipulative and deceptive devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate

commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

STATEMENT OF THE CASE

This is an action, based upon a unique set of

facts, for damages under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78 j(b), and Rule 10(b)-5 promulgated thereunder, 17 C.F. R. §240.10(b)-5. After dismissal of its complaint upon the grounds that plaintiff lacked standing to sue under Section 10(b), respondent appealed to the Ninth Circuit Court of Appeals. The appellate court in a 2-1 decision reversed the district court and remanded the case for further proceedings. The rationale of the Ninth Circuit was that the plaintiff, although technically not a purchaser or seller, nevertheless, could maintain an action under §10 (b) since it enjoyed a right, equivalent to that flowing from a contractual relationship, to purchase securities of the defendant corporation.

1. Relevant Facts Preceding The Filing Of This Action.

In order to highlight the singularity of the facts in the case at bar and to provide an essential and informative background for the institution

of the present action, it is necessary that respondent set forth certain facts and circumstances which precipitated the litigation at bar.

As a result of various alleged violations of the Sherman Anti-Trust Act, the United States government filed a civil anti-trust action against the defendants, Blue Chip Stamp Company and all of the other corporate defendants named herein. (R. at 4; App. E at E-5.)

Prior to a consent decree being entered in 1967 (R. at 21), the district court permitted entry into the anti-trust litigation by several amici curiae, including the California State Attorney General, the California Grocers Association and Certified Grocers of California, Ltd., each of which included within their constituency a substantial portion of the Users herein (it should be clarified at this point that the Users, plaintiffs herein, are comprised of the various retailers who issued Blue Chip stamps to consumers as a reward for their patronage). A significant facet

of the Consent Decree which was finally entered concerned a reorganization of Blue Chip Stamp Company into the presently constituted Blue Chip Stamps. No less than three reorganization plans were submitted to the district court. The avowed purpose of each such plan was to effectuate the divestment of the corporate defendants of their stock holdings in Blue Chip Stamp Company and to atone for the attempted defeasement of the equitable ownership in Blue Chip Stamp Company as urged by the Users through the amici curiae. As not just indicative, but conclusive, of the clear purport of the reorganization plan which was eventually approved by the court, the following is offered.[1]

---

[1] The quotations which follow are derived from the official records and documents filed with the district court in the anti-trust action. The pertinent portions of these records and documents were presented to the Ninth Circuit Court of Appeals in Plaintiff-Appellant's Supplemental Brief, attached hereto as Appendix A. The salient portions thereof were reviewed and considered by the Ninth Circuit

These verified statements demonstrate that the fears expressed by the dissenting opinion below and petitioners herein are not only ill-founded, but contrary to what was intended by the parties and the court in agreeing to the eventual Consent Decree:

> ". . . Blue Chip's present net assets . . . should be regarded as beneficially belonging in proportion to their patronage, to all retailers who made it what it is today." (App. A hereto at pp. 8-9; Brief of the State of California As Amicus Curiae, filed November 15, 1966, p. 77, ll. 10-12.)

> "From its inception, Blue Chip was promoted as being run for the benefit of the

---

Court of Appeals and were relied upon in part as a basis for its decision. (See Opinion, Footnote 4, App. A of Petition, p. A-3.)

users whose help was enlisted in its promotion.

"The consenting parties have not addressed any comments to this point. However, much as they would, they cannot close their eyes to the role of the non-defendant users and their very real equity in Blue Chip, its name, its good will and the value of its established business.

"The rights of thousands of California merchants relate not only to the unpaid patronage dividends but also to the other more valuable assets of Blue Chip. So long as any settlement of this case fails to recognize these rights of non-defendant users, the required determination that such settlement is equitable and in the public interest cannot be made." (emphasis ours) (App. A herein at pp. 10-11;

Reply Brief of California Grocers Association And Certified Grocers Of California, Ltd., As Amicus Curiae, pp. 12-15, filed December 5, 1966.)

In seeking Court approval of the Reorganization Plan and in defense of their "bargain offering" to the Users the defendants stated:

". . . The Reorganization Plan has two basic purposes and objectives, namely . . . (2) to compromise disputed claims which had been asserted by representatives of California Grocers' Association, Certified Grocers, and others on behalf of non-stockholder users . . . It became apparent that such settlement could not be achieved without offering non-stockholder users an opportunity to acquire an equity interest at a price sub-

stantially equivalent to that originally paid by the present stockholders. " (emphasis ours) (App. A at p. 15; Reply To Memorandum of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan of Blue Chip Stamp Company Lodged With the Court August 3, 1967, p. 7. ll. 7-18, filed August 22, 1967.)

If there be any doubt that the Court, too, recognized this equitable interest in the Users and intended that it be accounted for in the Consent Decree, such doubt is allayed by the Court's following statement:

" The decree herein is designed to limit the powers of Blue Chip and to open up and increase competition in the stamp industry in California, while at the same time preserving the legitimate interests

of the users of Blue Chip Stamps. (emphasis ours) (App. A at p. 16; Order Denying Motions To Intervene And To Vacate Consent Decree, p. 18, ll. 6-10, entered August 8, 1967.)

In a hearing subsequent to Court approval of the Consent Decree and Plan of Reorganization, Mr. William W. Alsup, on behalf of Blue Chip Stamps, conceded that the "Users" were intended to be benefitted by the Consent Decree and Plan of reorganization thereunder:

"Mr. ALSUP: We do think we need a hearing date obviously to go into the question of who of these users are entitled to subscribe, assuming Mr. Raley and his group are not, and we take care of these users, as was intended." (emphasis ours) (App. at p. 16; Reporter's Transcript Of Proceedings, Monday, Nov-

ember 4, 1968, Thursday, November 7, 1968, p. 12, ll. 8-12.)

At a hearing subsequent to approval of the reorganization plan, Mr. Wallace Howland on behalf of the State Attorney General sounded almost as if he had the present litigation in mind when he addressed the Court as follows:

"Mr. HOWLAND: So what we have here, if the court please, is a right, a legally cognizable right conferred upon the user by the plan of reorganization approved by order of this court. It was a right, in effect, to compel Blue Chip Stamp Company to issue its units to a user, and it was a right that each user could either exercise or waive in his discretion." (emphasis ours) (App. A at p. 20; Reporter's Transcript of Proceedings, Monday, November 4, 1968, Thursday

November 7, 1968, pp. 42-43.)

2. Allegations Of The Complaint.

As stated above, a Consent Decree was approved and entered in the aforementioned antitrust litigation, a material portion of which was the reorganization plan. Such plan provided, in pertinent part, as follows:

> "An offering of approximately 621, 600 shares of its common stock would then be made by New Company (defendant BLUE CHIP STAMPS) to users of BLUE CHIP STAMPS (who issue stamps to their retail customers as a reward for patronage) other than users who are also shareholders of BLUE CHIP (such users to whom such offering is to be made are hereinafter referred to as 'Users') on a pro rata basis determined by the quantity of stamp pads issued to Users during the period subsequent to

March 1, 1964, and prior to a date to be determined which will be not more than ninety (90) days prior to the effective date of registration statement hereinafter referred to. The offering will be made in units consisting of three (3) shares of the common stock of New Company (defendant BLUE CHIP STAMPS) and one (1) One Hundred Dollars ($100.00) principal amount debenture for a cash consideration of One Hundred and One Dollars ($101.00)." (R. at pp. 22-23; App. E of Petition, p. E-6.)

The Consent Decree further provided that those shares which were not purchased by the Users under the offering above could be sold by the defendants to the public at their then current market value. (R. at p. 23.)

In 1968, the defendants, in connection with the required offering, mailed to the Users various

documents, including a prospectus dated August 29, 1968. It is alleged that said prospectus grossly misrepresented the true value of the offered shares of Blue Chip Stamps and unjustifiably denegrated the then present and future financial condition and prospects of said company. This "negative prospectus" was the embodiment of a fraudulent scheme of the defendants to dissuade the Users from exercising their rights to purchase said shares at a "bargain price" ($8.67), to the end that the defendants could sell the unsubscribed shares on the open market at their then market value ($90.00 per share). (R. at pp. 25-30.)

As a result of these misleading and fraudulent practices of the defendants, many of the Users, including the plaintiffs herein, were dissuaded from exercising their rights in purchasing the offered shares.

Approximately one year later, the defendants offered shares of Blue Chip Stamps to the general public at a price of $90.00 per share. This general offering was accompanied by a new and different prospectus (R. 107) which differed materially and substantially from the "negative prospectus" distributed to the Users, although the negative elements emphasized in the "negative prospectus" would have been as relevant, if true, to the offering made to the general public a year later. (R. at pp. 27-30; App. E at pp. E-11 to 14.)

The alleged distinction in the Petition that the shares which were sold a year later were not the identical shares offered to the Users is irrelevant. The thrust of the aforesaid allegations

is to demonstrate that those shares which were required to be offered to the Users were to be at a "bargain price" and it is unimportant whether those offered to the Users, or those retained by the corporate shareholders, were the identical securities sold at a later date on the public market for a considerably higher price. The crux of these allegations is that the offering that was required to be made to the Users was to be at "bargain price", because of the equitable ownership of the Users in Blue Chip Stamp Company.

The Reorganization Plan required that Blue Chip Stamps offer 621,600 shares of its common stock to the Users. (R. at p. 22; App. E of Petition, p. E-6.)

Based upon a formula calculated upon the number of stamp pads purchased by the Users, each offeree would be entitled to subscribe to units consisting of three shares of the new Company, Blue Chip Stamps, and a six and one-half per-

cent subordinated debenture for the purchase price of One Hundred and One Dollars ($101.00). This purchase price was intended to be and was, in fact, a bargain (R. at pp. 23-24). The aforesaid units were reasonably worth Three Hundred and Fifteen Dollars ($315.00) at the time of the offering. (R. at pp. 24-25.)

In connection with the required offering of said shares to the Users, the defendants caused to be published a prospectus (R. at pp. 70-106). The defendants, however, did not want the Users to exercise their rights under said offering (R. at p. 25) for the reason that the price at which the shares were offered to the Users was a bargain and the defendants had the right under the Plan to sell unsubscribed shares at a more truly fair market value. (R. at pp. 27-28.)

Within a year after the offering to the Users, certain of the defendants offered to the public (R. at pp. 25-27.) over 300,000 of the original shares shares at a price of Ninety Dollars ($90.00) per share.

The required prospectus in connection with the offering to the Users highlighted and emphasized five items of special interest of a negative character which were thereafter referred to individually or collectively within said prospectus approximately fifteen different times. (R. at p. 27.) When the defendants themselves, one year later, offered their own shares to the general public, a different prospectus (R. at pp. 27-28) was published which contained no such negative items of special interest, although to the extent that they were relevant at the time of the offering to the Users, they were relevant at the time of the later prospectus. (R. at p. 28.)

The dichotomy between the aforesaid prospectuses was the product of a fraudulent scheme by the defendants to discourage the respondents herein from exercising their right to purchase said shares at a bargain price in order that the defendants could realize a sale upon the public

market of their shares at a premium price and thus avert the intended purpose of the aforementioned Consent Deecree. (R. at p. 25.)

The respondents herein represent those Users who, as a result of the fraudulent schemes and practices of the defendants, were dissuaded from exercising their right to purchase shares in new Blue Chip.[2] (R. at pp. 30-31.)

ARGUMENT

1. Do Section 10(b) Of The Securities Exchange Act Of 1934, 15 U.S.C. 78j(b), And Rule 10b-5 Of Tthe Securities And Exchange Commission Deny Standing In A Civil Damage Action to A

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[2] Any argument that the offering to the Users was not intended to be or was not, in fact, a "bargain" ignores the clear language of the complaint herein. (R. at p. 24; App. E of Petition at p. E-8.) It is further alleged that the price of the shares offered to the Users was $8.67 per share (R. at p. 31; App. E of Petition at p. E-15) and that the shares which were offered to the general public a year later were at price of $90.00 per share (R. at p. 28; App. E of Petition at p. E-12.)

Plaintiff Who Has A Right Or Entitlement To Purchase Securities But Is Deprived Of Exercising Said Right Or Entitlement Because Of The Fraud Of Tthe Offeror?

It cannot be over-stressed that the facts in the present case present a situation unlike any other with which a court in determining standing under section 10(b) and rule 10b-5 has had to wrestle. Succinctly stated, we have here the anomalous circumstance wherein a defendant under the mandate of a court decree must offer, to a specified class, securities at a bargain price, yet which offering, for reasons of its own monetary gain the defendant hopes and attempts to insure through its fraud will be unsuccessful.

Petitioners have prayed that this Court review the opinion below because it allegedly conflicts with decisions in the Second, Third, Fifth, Sixth, and Eighth Circuit. In so urging, Petitioners fail to recognize the unique facts and cir-

cumstances in the present case and misunderstand the holding in the present case.

The Securities Act of 1933, 15 U.S.C. § 77a, et seq., and the Securities Exchange Act of 1934, 15 U.S.C. § 78a, et seq., were enacted in part to restore the public's confidence in the stock market following the public investment frauds of the 1920's and the market crash of 1929. Rule 10b-5 was promulgated as a broad anti-fraud provision, designed to reach a wide scope of deceptive activities in Securities transactions. Ever since the decision in Birnbaum v. Newport Steel Corp., 193 Fed. 2d 461 (2d Cir. 1952), cert. den. 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed 1356 (1952), courts have employed various rationales in attempting to retreat from what was believed to be the highly technical and restrictive rule of the Birnbaum case. It had long been felt that the Birnbaum interpretation of the language of section 10(b) and rule 10b-5 language " in connection

with the purchase or sale of any security" required that there must be an actual purchase or sale before standing could be granted to an aggrieved plaintiff in a civil action under the Act of 1934.

Soon, however, the courts began to recognize the inequity in denying such standing to parties who were clearly within that class of persons intended to be protected by securities legislation.

Thus, even though there had been no purchase or sale effected, the courts in examing facts and circumstances of each case have granted standing, for instance, in cases where plaintiffs had found themselves in the position of being a "forced seller" in the future,[3] where the only

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3 Vine v. Beneficial Financial Company, 374 F.2d 627, cert. denied, 389 U.S. 970 (1970); Dasho v. Susquehanna Corp., 380 F.2d 262

transaction had been a corporate merger[4] or issuance by a corporation of its own shares,[5] where the plaintiff was a stock brokerage firm which had ordered securities for which customers later refused to pay[6], and where plaintiffs had unwittingly purchased non-existent stock.[7]

(7th Cir. 1967); Mader v. Armel, 402 F. 2d 158 (6th Cir. 1968), cert. denied, 394 U.S. 940 (1969).

4 Coffee v. Permian Corp., 434 F. 2d 383 (5th Cir. 1970).

5 Hooper v. Mountain States Securities Corp., 282 F. 2d 195 (5th Cir. 1960), cert. denied, 365 U.S. 814 (1961); Ruckle v. Roto American Corp., 339 F. 2d 24 (2d Cir. 1964); Schoenbaum v. Firstbrook, 405 F. 2d 215 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969).

6 A. T. Brod & Co. v. Perlow, 375 F. 2d 393 (2d Cir. 1967).

7 Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N. D. Ill. 1967).

While here we have the situation where the plaintiffs were dissuaded from purchasing securities to which they were entitled, in Stockwell v. Reynolds & Co., 252 F. Supp. 215 (S. D. N. Y. 1956), the plaintiffs were granted standing under section 10(b) where they had been dissuaded from selling their shares.

These judicial interpretations of the purchase or sale language of §10(b) and their manifest trend toward extending the scope of plaintiffs are consistent with the view expressed by this Court in Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U. S. 6, 12 (1971):

> "Section 10(b) must be read flexibly, not technically and restrictively."

In each case the plaintiff must demonstrate its membership in the "special class" protected by Rule 10b-5. (Eason v. General Motors Acceptance Corp., 490 F. 2d 654, 660 (7th Cir. 1973). The court below performed this test, not-

ing that a common link exists in the cases, as cited above, which have granted standing to non-purchasing or non-selling plaintiffs. That common link is "the existence of a contractual relationship between the parties". (App. A of Petition at p. A-10; App. B of Petition at p. B-2.) Whether plaintiff's right to purchase the subject shares emanated from a contract, a Consent Decree or other relationship, the central issue is whether that relationship brings the plaintiff within the umbrella of Section 10(b) coverage. In the case at bar it clearly did.

Petitioners contend that the Third, Fifth, Sixth, and Eighth Circuits have steadfastly refused to permit standing to one who is neither a purchaser, nor a seller. Respondent takes issue with that claim. Petitioners misread the rule of the Birnbaum case as it has become to be defined. The plaintiffs in that case sought redress under Section 10(b) for internal corporate mismanagement. They were, in no sense, purchasers, sel-

lers, offerors, or offerees. They enjoyed no unique relationship with the defendant which could be said to be within the class of persons that Congress had intended that the Act protect. Despite declarations to the contrary, Birnbaum simply stands for the proposition that Section 10(b) is not the proper vehicle in a civil damages action for the correction of internal corporate mismanagement. (See, Bankers Life, supra, at p. 12.)

Thus, the Sixth Circuit case, Simmons v. Wolfson, 428 F. 2d 455 (1970), which petitioners cite as authority for their position is merely a reiteration of the limited holding in Birnbaum concerning the type of fraud covered by §10(b). In Simmons, as in Birnbaum, the plaintiffs alleged fraud on the part of corporate officers and directors and sought damages through Section 10 (b). The court refused to grant standing to plaintiffs, holding, consistent with the true holding in Birnbaum:

"In our opinion, adoption of appellants'

contention . . . would open the door to federal jurisdiction in claims for damages against corporate directors and officers arising out of breach of their fiduciary duties." (428 F. 2d at p. 456.)

Moreover, in a recent Sixth Circuit opinion, James v. Gerber Products, Co., 483 F. 2d 944 (1973), the court expressly acknowledged the limited application of Birnbaum:

"We view Birnbaum's import as denying shareholders a federal courtroom to litigate all matters of alleged corporate fraud under the auspices of Rule 10b-5." (483 F. 2d at p. 949.)

Landy v. Federal Deposit Insurance Corp., 486 F. 2d 139 (3rd Cir. 1973) and Sargent v. Genesco, 492 F. 2d 750 (5th Cir. 1974), relied upon by petitioners (Petition at p. 15), both present facts clearly distinguishable from the case at bar. In Landy the plaintiffs complained of fraud

committed by the former president of a now insolvent bank who had abused his position as an officer and misused funds of the bank in order to participate in various securites transactions totalling over Two Hundred Million Dollars. The plaintiffs, shareholders of the bank, were unable to state a claim under §10(b) because they simply had not engaged in any fashion in those securities transactions. (486 F. 2d at p. 158.) It was clear to the court that what they really sought was relief under §10(b) for corporate mismanagement. These circumstances are to be contrasted with those present in the instant case. There is no issue in our case concerning corporate mismanagement, nor is there any doubt that the present plaintiffs possess the requisite nexus between the injury which they suffered and the fraud employed by the defendants in connection with its offering and sale of the subject securities.

Similarly, in the Sargent case, the plaintiff-shareholders were unable to show that they

had "been involved in an actual purchase or sale of stocks in connection with the conduct" alleged to be violative of § 10(b). (492 F. 2d at p. 762.) The plaintiffs had already been shareholders when there occurred the fraud as alleged. Although the value of their stock had undoubtedly suffered greatly, their initial purchase of securities bore no rational connection to the later perpetrated fraud.

The Eighth Circuit case relied upon by petitioners suffers from the same defect. In Erling v. Powell, 429 F. 2d 795 (1970), the plaintiff-shareholders complained of fraud by majority shareholders in connection with a sale by the latter of a large block of stock to a third party. The plaintiffs had no connection whatsoever with this transaction, except to the extent that their own holdings were depressed. The plaintiffs were not purchasers or sellers of securities, nor did they, contrary to the case at bar, have any right or entitlement to participate in the subject trans-

actions. As correctly summarized by the court, the plaintiffs' claim merely rested "upon an alleged breach of fiduciary duty owed the corporation and other shareholders". (429 F. 2d at p. 800.)

In a case which presented the other side of the coin of the instant case, the Eighth Circuit granted standing to plaintiffs who had been induced to "hold" their shares, rather than sell them. (Travis v. Anthes Imperial Limited, 473 F. 2d 515 (1973), citing with approval Stockwell v. Reynolds & Co., supra.)

While the Second Circuit has been the most conservative in refusing to vary from the strict construction of the purchaser-seller requirement, these are signs that it, too, recognizes the need for a case by case analysis in determining the issue of standing.

> "The purchase-sale requirement must be interpreted so that the broad design of

the Exchange Act, to prevent inequitable and unfair practices . . . is not frustrated by the use of novel or atypical transactions . . . 'In determining who has standing to enforce duties created by statute, a court's quest must be for what will best accomplish the purposes of the legislature.'" (Crane Company v. Westinghouse Air Brake Company, 419 F. 2d 787, 798 (2nd Cir. 1969).)

The case of Haberman v. Murchison, 468 F. 2d 1305 (2d Cir. 1972), cited by petitioners at page 14 of their petition, has no application to the issue before this Court.

There, as in other cases which have been discussed herein, the plaintiff cited as fraudulent a sale by corporate officers and directors of stock to a third party. Again, plaintiff had no transactional connection or "right" in the subject sale. Because this link to the fraud was lacking,

the complaint under section 10(b) was dismissed. Again, this actual grievance pertained to internal corporate mismanagement, the one type of §10(b) claim clearly proscribed by Birnbaum.

Since the decision below in the instant case, the Seventh Circuit issued its landmark opinion in Eason v. General Motors Acceptance Corporation, 490 F. 2d 654 (1973). [8] Whatever vitality the Birnbaum case had retained (other than its proscription of corporate mismanagement cases) was laid to rest by the Eason decision.

In Eason there did occur a sale of securities, but the parties to the sale were a defendant and another party. It was a securities transaction in which the plaintiffs were not participants. Plaitiffs were shareholders of Bank Service Corporation (not a party to the action), which issued 7,000 of its shares to defendant Waite in

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8 This court denied a writ of certiorari in Eason on April 22, 1974.

exchange for all of the assets of the latter company. As further consideration for the acquisition, BSC assumed all liabilities of Waite, including notes payable to GMAC. As part of the agreement, GMAC required and obtained personal guarantees of said notes by plaintiffs. BSC later defaulted on the notes and in a separate action GMAC sued plaintiffs on their guarantees. It was discovered, however, that both Waite and GMAC had made material misrepresentations concerning the true value of the former's assets and plaintiffs then brought this §10(b) action.

These facts show that the Eason plaintiffs were not purchasers or sellers, nor parties to a contract of purchase or sale, nor were they holders of a right which might be deemed an equivalent to a contractual right to purchase or sell securities. Nevertheless, they were granted standing under §10(b). Upon analyzing the Birnbaum decision and articulating its actual, limited holding, the Court in Eason suggests that the real

issue in determing the availability of §10(b) relief should not be one of "standing", but rather, whether plaintiffs are members of the class for whose special benefit Rule 10b-5 was adopted.

The Eason decision then established a test for determining whether a plaintiff comes within the intended class of protected persons:

> "Congress, the Supreme Court, and the [Securities Exchange] Commission have all used the term 'investors' to describe the class of persons protected by Rule 10b-5. Thus, the statutory authorization for the rule refers to the prohibition of deceptive devices 'for the protection of investors'." (Insert ours) 490 F. 2d at p. 659.

The court, however, does not suggest that the term "investors" be construed in the technical sense of a shareholder. "Investor" is defined in the opinion as someone who has a "stake"

or "interest" in the purity and outcome of a securities transaction.

> "The plaintiffs in this case were certainly 'investors' in the transaction which is allegedly tainted by fraud. Their interest as stockholders of Bank Service Corporation was apparently sufficient to induce them to execute substantial personal guarantees. As individual guarantors they were direct parties to the transaction in dispute. If, as plaintiffs have alleged, the transaction was consummated in violation of the Rule 10b-5, we believe the plaintiffs, as investors and as principals in the transaction, suffered a legal injury which may be redressed by a federal court." 490 F. 2d at pp. 659-660.

It is submitted that the plaintiffs in the pres-

ent case have no less an interest or stake in the securities transaction which is the subject of this action.[9]

In summary, respondent suggests that the conflict within the Circuits, which petitioners would have us believe would result by virtue of the decision below, is illusory. All of the cases cited by petitioners represent: (1) the unanimous trend in determining the purchaser-seller standing issue on a case by case basis and (2) the consensus of courts that mere internal corporate mismanagement is not a proper subject for a section 10(b) action. To deny standing under the facts and circumstances present here would be to exonerate from liability the petitioners because they were successful in their fraudulent scheme; that is, dissuading the offerees from exercising

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9 The court in Eason cited with approval the opinion below in the case at bar. See, 490 F. 2d at p. 660, footnote 25.

their "right" to purchase the mandatorily offered securities.

2. The Decision Below Does Not Deal With The Question Of Whether An Amicus Curiae May Enforce A Consent Decree, Nor With The Policy And Intent Of The Securities Act Of 1933.

The majority opinion below does not conflict with this Court's decision in United States v. Armour & Co., 402 U.S. 673 (1971), or other cases to the same effect. There is nothing expressed or implicit in the opinion which suggests that the plaintiffs herein may or are enforcing the Consent Decree in the anti-trust litigation.

The court's discussion of the Consent Decree serves as important historical background in understanding why the plaintiffs in the present case differ materially from any other interested investor. There is no suggestion in the opinion that plaintiffs are attempting to enforce the Consent Decree in a masked collateral proceeding or that they could ever do so. From that Con-

sent Decree, however, and the clear intent and purpose behind it flow the unique rights of the plaintiff-offerees. Had the court reasoned that plaintiffs were hereby enforcing the decree it would not have analogized their status as one which is the "functional equivalent" of a contractual relationship. If plaintiffs were enforcing or entitled to enforce the Consent Decree an actual contractual relationship would have been established. Such is not the import of the court's language.

The Armour case involved an attempt by the government to, in effect, modify a Consent Decree in order to protect against an evil which had not been anticipated at the time the Decree was entered. The court refused to go beyond the language of the Decree and adopt a construction that would "satisfy the purposes of one of the parties to it." (402 U.S. at p. 682.)

Specifically the court held:

" . . . the scope of a consent decree must be discerned within its four corners, and not by reference to what might satisfy the purposes of one of the parties to it." (402 U.S at p. 682.)

Contrary to the contentions of the petitioners, Armour does not suggest that a court may not take judicial notice of its own files and records in order to determine what is meant by certain language. The fact that the Reorganization Plan (R. at pp. 54-68) provides for an offering of 621,600 shares of new Blue Chip Stamps to "users" as opposed to the general public, that the new company would insure that these users would receive notice by advertisement of the proposed offering (R. at pp. 60, 67), and that any shares purchased by the users would not be transferrable lead one to inquiry regarding the uniqueness and intent behind such an offering. Furthermore, the Reorganization Plan, itself, refers

to the "right of the Users to prove their entitlement to units". (R. at pp. 67-68.)

Consequently, the court below properly examined the relevant documents in the anti-trust litigation in order to ascertain the relationship of the plaintiffs to the defendants in both that precdent case and in the present action. [10]

Because, as discussed above, plaintiffs are not attempting to enforce a Consent Decree, the petitioners' claim that a conflict has been created with reference to the decision in Data Proc. Fin. & Gen. Corp. v. International Bus. Mach. Corp., 430 F. 2d 1277 (8th Cir. 1970), is not well taken. Respondent agrees that a non-party may not directly and collaterally enforce a Consent Decree. No such attempt, however, is made in

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10 See Footnote 4 to the Opinion below (App. A of Petition at p. A-3) and cases cited therein.

the present case. An examination and analysis of the Consent Decree and the appurtenant documents thereto merely serve to explain and sustain the "right" or "entitlement" which the plaintiffs claim to have enjoyed (R. at pp. 7-8; App. E of Petition at p. E-9.)

The fact that the securities transaction that is the subject matter of the claim was mandated by the Consent Decree does not immunize the defendants from the statutes and rules regulating securities transactions. Plaintiffs herein rely upon a breach of duty imposed by these statutory anti-fraud provisions, not upon a breach of duty imposed by the Consent Decree. This is the argument used by the majority below in anticipating and dismissing the precise argument raised in the petition herein.[11]

Equally misplaced is petitioners' purported concern that the decision below presents the

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[11] See App. A of Petition at p. A-10, Footnote 14.

drafter of prospectuses with an "almost impossible task." (Petition at p. 24.) Respondent submits that it takes very strained reasoning or reaction to suggest the alarm which petitioners pretend with reference to the Opinion's alleged effect upon the duties required of future offerors. To suggest that the Opinion changes and undermines the purpose and policy of the Securities Act of 1933 is blatant alarmism in an attempt to convince this Court that it should grant review in the present case.

Respondent agrees that a requirement for disclosure of and emphasis on adverse matters "comports with Congress' purpose of protecting investors from issuers 'puffing' the value of their securities by minimizing the risks inherent in their purchase." (Petition at p. 23.) This policy deters those issuers who are overly enthusiastic about selling their securities. But there is nothing in that policy or in the language of the Act which licenses <u>over-emphasis</u>, as part of a fraud-

ulent scheme, of negative matters in order to dissuade sales. Unfortunately, this is the situation in the case at bar, peculiar as it may be. An issuer would clearly not be permitted to "puff" the negative aspects of an offer any more than it would be allowed to highlight its positive aspects.

No citation is necessary for the proposition that all that the 1933 Act requires is an honest and fair disclosure and presentation. If an issuer fraudulently fails to so, liability attaches under securities legislation and regulations, including section 10(b) where applicable. It is the duty of the trier of fact to determine whether an issuer has complied with the mandates of the Act and its regulations. Here, the complaint alleges that the defendants conspired to violate those mandates by deliberately over-emphasizing the negative "items of special interest" (R. at pp. 25 29 App. E of Petition at pp. E-10 to E-14). For purposes of this review, the allegations are deem-

ed to be true. At a trial of this case, it is the burden of the plaintiffs to establish that defendants have unduly over-emphasized the negative elements of the subject offer in furtherance of a fraudulent scheme.

If at trial plaintiffs prevail on that issue, then, and only then, is petitioners' concern about offeror's duties of disclosure under the Securities Act of 1933 potentially justiciable. Until such determination, however, the contention that issuers are now faced with an impossible burden is premature as is the claim that the decision below presents an important question of federal law which should be settled by this Court.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be denied.

Respectfully submitted,

J. J. BRANDLIN

Attorney for Respondent

Of Counsel:

JAMES E. RYAN
RAY E. McALLISTER

October,

SUMMARY OR ARGUMENT

The facts in the instant case present a unique circumstance in Section 10(b) litigation in that the plaintiffs, while technically not purchasers or sellers, owned a "right" to purchase the securities offered by defendant. That "right" served as the functional equivalent of a contractual relationship, a basis upon which Courts have historically granted standing under §10(b). Because of this unique right and the facts peculiar to this case, the decision below has singular application to the case at bar and, as so distinguished, does not conflict with decisions of other Circuits.

Moreover, the cases cited by petitioners as allegedly representing a contrary view on the issue of standing all have in common factual situations whereby there is either an attempt by shareholders to use §10(b) as a vehicle of redress for internal corporate mismanagement or the claim by a party that it has suffered a loss as

a result of fraud in connection with the sale of a security by the defendant to a third party. Neither of these factual situations or claims is presented herein.

The Opinion below does not hold, even implicitly, that respondent is entitled or is even attempting to enforce an anti-trust Consent Decree. Nor does the decision present an important question of law concerning the disclosure duties of an issuer under the Securities Act of 1933. Not only does the Opinion not raise such an issue, that question would not be justiciable until there had been a trial on the merits.

APPENDIX A

Appendix A

UNITED STATES COURT OF APPEALS

FOR THE NINTH SIRCUIT

[Filed August 15, 1972]

MANOR DRUG STORES, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps. Plaintiff-Appellant, vs. BLUE CHIP STAMPS, BLUE CHIP STAMP COMPANY, LUCKY STORES, INC., MARKET BASKET, PURITY STORES, INC., RALPHS GROCERY COMPANY, SAFEWAY STORES, INC., THRIFTIMART, INC., THRIFTY DRUG STORES CO, INC., VON'S GROCERY CO., ROBERT E. ALEXANDER, DONALD A. KOEPPEL, LEONARD M. STRAUS, WILLIAM F. RAMSEY, ROBERT E. LAVERTY, RICHARD RALPHS, JOHN R. NIVEN, FRED VON DER AHE, Defendants-Appellees.	No. 71-2223 PLAINTIFF-APPELLANT'S SUPPLEMENTAL BRIEF

I. PRELIMINARY STATEMENT

In response to the Court's order, plaintiff-appellant herewith submits its brief regarding the recent Ninth Circuit decision in Mount Clemens Industries, Inc. vs. Bell, No. 71-1318, decided June 28, 1972. The Securities Exchange Commission, which has appeared heretofore in this proceeding as amicus curiae, has has likewise been requested to file a brief. It is plaintiff-appellant's understanding from conversations with Securities Exchange Commission's counsel that their brief will primarily urge that the Mount Clemens decision be rejected in toto by this Court. While we join in the brief of the Securities Exchange Commission and the arguments raised therein, at the same time we feel that the

Mount Clemens case supports the position that has been consistently urged by plaintiff-appellant herein. Although we feel that the Mount Clemens case and the one at bar present dissimilar facts and therefore necessarily different questions before the Court, we nevertheless fell that much of the language of the Mount Clemens opinion and the crux of the rationale support and affirm this plaintiff-appellant's contentions.

Although we share in the Security Exchange Commission's disappointment over the Court's refusal to disaffirm the Birnbaum doctrine in toto, we do not find the Mount Clemens decision to be a hindrance in any other respect. The Mount Clemens case is easily distinguished from the one at bar. There, certain corporate securities were offered at an ordinary public auction. Plaintiffs were merely members of the general public interested in purchasing the subject securities. Defendant represented to the plaintiffs that the securities were worthless and it is alleged that the plaintiffs were thereby induced not to bid at the sale. There was no allegation by the plaintiffs that they enjoyed any status or had any special rights other than that of all other members of the public. There was no previous relationship between the parties which gave rise to any duty on the part of the defendant or any "right" on behalf of the plaintiffs to engage in the securities transaction. The Court in Mount Clemens made the following observation which we contend to be of significant importance:

> "Plaintiffs were not even induced to refrain from accepting an outstanding offer" (emphasis ours)(Slip. Op. at page 10 , footnote 11.)

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The gravamen of the amended complaint in the present case concerns and alleges the very existence of an outstanding offer. (Amended Complaint, paragraph XVI, R.13) Additionally, it is alleged in our Amended Complaint that the "Users" herein enjoyed a unique status, which status "Prompted The Plan and the offering." (Amended Complaint, paragraph X, R.6-7, 1.28)

We contend, therefore, that the crucial question before this Court is whether or not the plaintiffs-appellants herein possessed a special and exclusive right or owned an equitable interest within the protective provisions of Section 10(b). If the Court concludes that the complaint does not allege with sufficient clarity the special right of plaintiff's to purchase the offered stock, plaintiffs ask leave to amend the complaint to conform to the following facts.[1]

In light of certain of the language in the Mount Clemens decision and by virtue of certain deductions the undersigned has made as a result of the Court's questions at the time of oral argument of this matter, this brief will be limited to an elucidation of the status of the plaintiff-appellant at the time of the subject violation of Section 10(b).

II. THE MOUNT CLEMENS DECISION SUPPORTS PLAINTIFF-APPELLANT'S CONTENTION THAT IT HAS "STANDING" UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934

Initially, it must be noted with much importance that the Mount Clemens opinion specifically adopts the view which has been persistently urged by plaintiff-appellant throughout these proceedings, to wit: that a plaintiff is not dependent upon an actual purchase or sale in order to state a cause of action under

1. ... (T)he accepted rule (is) that a complaint should not be

Section 10(b). Specifically, the Court stated:

> "These allegations clearly reveal that plaintiff never actually purchased or sold the Missile stock. Yet that circumstance does not end our inquiry, for under the liberal interpretation that has sometimes attended the application of the Birnbaum Doctrine there have been cases in which standing has been afforded to persons who, even though not actual purchasers or sellers, have been deemed to have the required status. (citing cases)" (Slip. Op. at page 9)

Consequently, the Mount Clemens decision lays to rest a major issue regarding which both appellant and appellee devoted much of their previous briefs. Therefore, despite defendants-appelles' repeated arguments to the contrary, the amended complaint herein is not defective because it admittedly asserts that the "Users" were non-purchasers.

There can also be no question that the Mount Clemens decision holds that lacking the status of an actual purchaser or seller the plaintiff must demonstrate that it enjoys some other status for which relief should be afforded. The Court recognized that all of the cases which adopted the non-technical or liberal interpretation of the 10(b) standing language found that the plaintiff enjoyed the status of "a party to a prior agreement to purchase or sell" securities. The Mount Clemens Court observed

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dismissed for failure to state a claim unless it appears beyond a reasonable doubt that the plaintiff can prove no set of factors in support of his claim which would entitled him to relief." Conley vs. Gibson (1957), 355 U.S. 41, 46, 78 S.Ct. 99, 102, 2L.Ed. 2d 80.

that the cases which fall into the "aborted purchaser-seller cases" ((Opper vs. Hancock Secs. Corp., 367 F.2d 157 (2d Cir.), Aff'g. 250 F.Supp. 668 (S.D.N.Y. 1968); Goodman vs. H. Hentz & Co., 265 F. Supp. 440 (N.D.Ill. 1967); Stockwell vs. Reynolds & Co., 252 F.Supp. 215 (S.D.N.Y. 1965)) all presented evidence of such a prior agreement or "contractual relationship". At the same time, the Court noted:

> "We recognize that the term 'contract' in Sections 3(a) (13) and 3(a) (14) must be given a broad, liberal interpretation (citing cases). (Slip Op. at page 11 , footnote 12.

As is obvious from the very title of the category of such cases, each of the plaintiffs in the "aborted purchaser-seller" cases was frustrated from consummating a specific purchase or sale of securities. The courts, of course, did not deny these plaintiffs relief merely because they were never able to engage in the particular securities transaction. Rather, they were afforded standing under Section 10(b) because they had a right to participate in the transaction in question. In those cases above cited, the rights of the plaintiffs flowed from an agreement or a contract. We submit that the plaintiff-appellant herein similarly had a right to engage in a specific transaction. That right emanates from a court decree, based upon a stipulation (contract) in the government anti-trust case. The decree singled out the plaintiffs ("Users") and gave them a special right, distinct, unique and exclusive from the "man on the street" plaintiff in the Mount Clemens case.

We wish, therefore, to present to this Court the following historical, legal data which is the font of this entire litigation

and from which flowed the status of the plaintiff-appellant ("Users"). We therefore request that this Court take judicial notice of those citations and quotations from the record of the previous anit-trust lawsuit.[2]

III. THE RECORDS AND PLEADINGS OF THE GOVERNMENT ANTI-TRUST SUIT ESTABLISH THAT "USERS" HAD A "RIGHT" TO PURCHASE BLUE CHIP STAMP'S SECURITIES

As is alleged in the Amended Complaint(R.4-6) and has been briefed and argued in these proceedings, the basis of plaintiff-appellant's claim under Section 10(b) stems from the Consent Decree entered June 5, 1967 by the United States District Court in United States of America vs. Blue Chip Stamp Company, et al., No. 63-1552. This was a civil anti-trust action in which it was alleged in substance that the defendants had conspired to restrain competition in the trading stamp industry in California and had obtained an illegal monopoly therein. A chronological history of that litigation establishes the genesis of the "Users'" "rights" herein and the total fallacy in the defendants' contention that the "Users" had no more than an "opportunity" to purchase the securities in question.

The records in that case reveal that:

On July 29, 1966, the United States Government as plaintiff and all but two of the defendants therein agreed to and lodged with the Court a proposed consent decree. Said decree made no provision concerning any offering of securities to "Users"; nor was there any mention or recognition of said "Users".

The two non-consenting defendants were Thriftimart, Inc. and Market Basket. They were most adamant in their refusal to stipulate to the proposed consent decree and urged that the

2. Federal Appellate Court may take judicial notice of matters,

implications of any such decree would have a tremendous impact on the grocery and other retail industries in California which subscribed to Blue Chip's stamp program and the very economy of California in general. Thriftimart therefore petitioned the Court that the "retail customers" of Blue Chip be brought into the action as indispensable parties plaintiff or parties defendant (Motion of Thriftimart, Inc. For Order Re Proposed Final Judgment By Stipulation, filed July 29, 1966.)

The Court thereupon permitted the entry into the case by various amici curiae, among which was the Attorney General of the State of California. The Attorney General entered his appearance on behalf of all retail grocers of California who were non-defendants and in his capacity as parens patriae. (Amended Complaint, paragraph IX, R.23) The above-mentioned retail grocers therefore included a large number of the plaintiff-"Users" herein. On September 27, 1966, the California Attorney General filed his brief in opposition to the entry of the first proposed consent decree. Therein he stated:

> "It should be borne in mind that, in organizing Blue Chip, in their capacity as majority stockholders and promotors [sic] the defendant retailers caused it to be reported to the retail grocers of the State that Blue Chip would be non-profit to those who promoted it. It was in reliance upon such representation that several thousand retail grocers, not defendants in these proceeding, gave their

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even though not brought to the attention of the lower court, where necessary to show the impropriety of the lower court decision. International Brotherhood of Teamsters, Chauffers, Warehousemen and and Helpers of America vs. Canton Air Transport Corp., 394 F.2d 50 (6th Cir. 1968)

patronage to Blue Chip, and gave it to such an extent that in the aggregate they accounted for not less than 2/3 of the patronage Blue Chip enjoyed during the ten years of its existence. In point of fact, Blue Chip has been operated without profit to its stockholders as such. Consequently, and with fairness to all, Blue Chip's present net assets, tangible and intangible over and above the paid-up value of its share of stock, should be regarded as beneficially belonging to the retail grocers who made it what it is today." (emphasis ours) (Brief of the State of California As Amicus Curiae, p.42, ll.19-31, p.43,ll.1-4, filed September 27, 1966)

On October 3, 1966, the government-plaintiff withdrew its approval of the proposed consent decree.

On October 28, 1966, a second proposed consent decree was lodged with the Court. This decree was substantially the same as its predecessor and again contained no provision for an offering of securities to non-defendant "Users" or otherwise any mention or recognition of that class. On October 28, 1966 by its Order of same date, the Court instructed defendants and amici curiae to file objections to the second proposed consent decree.

On November 15, 1966, the State Attorney General filed its brief objecting to the proposed decree. Again he objected to the decree's failure to recognize the beneficial or equitable interest of the non-defendant "Users":

"Blue Chip's present net assets, tangible and

intangible, over and above the paid-up value of its shares of stock, should be regarded as beneficially belonging, in proportion to their patronage, to all the retailers who made it what it is today." (Brief Of The State Of California As Amicus Curiae, p.77, ll.8-12, filed November 15, 1966)

As an appendix to his brief, the Attorney General submitted a proposed consent decree which provided that upon dissolution of Blue Chip Stamp Company there be a distribution of its assets on a pro rata basis to the non-defendant "Users".

Also appearing in an amicus curiae stature were, jointly, the California Grocers Association and Certified Grocers of California, Ltd.. On December 5, 1966, they filed their brief in opposition to the second proposed consent decree and after tracing the origin and development of the Blue Chip Stamp Company and the representations which had been made to the non-defendant "Users", urged the Court:

"Out of this abundance of successful cooperative experience, the independent retailers of California believe that Blue Chip Stamp Company should be controlled and owned by the users, directly or indirectly." (emphasis ours) (Memorandum On Behalf Of California Grocers Association And Certified Grocers Of California, Ltd., As Amicus Curiae, p.37, ll.19-22, filed November 14, 1966)

Thriftimart, Inc. once again objected and filed its brief in opposition to the second proposed decree. Reiterating its

concern that the "Users" be joined as indispensable parties, Thriftimart in support of its contentions noted the aforementioned claims by the amici curiae:

> "As a result of this position, Certified Grocers and the California Grocers Association have taken the position that the assets of Blue Chip are held in trust for the users to the extent which these representations warrant." (emphasis ours) (Objections And Opposition (Of Thriftimart, Inc.) To Entry Of Second Proposed Consent Decree, Lodged October 28, 1966.)

The government-plaintiff and the consenting defendants filed briefs in response to the foregoing memoranda and, in general, urged that the proposed decree was fair and equitable to all concerned and that there was no just reason for delay in its entry.

A reply brief by California Grocers Association and Certified Grocers of California, Ltd. commented upon the plaintiff's and defendants' briefs and further emphasized the unrewarded claim of the non-defendant "Users":

> "From its inception, Blue Chip was promoted as being run for the benefit of the users whose help was enlisted in its promotion.
>
> "The consenting parties have not addressed any comments to this point. However, much as they would, they cannot close their eyes to the role of the non-defendant users and their very real equity in Blue Chip, its name, its good will and the value of its established business.

"The rights of thousands of California merchants relate not only to the unpaid patronage dividends but also to the other more valuable assets of Blue Chip. So long as any settlement of this case fails to recognize these rights of non-defendant users, the required determination that such settlement is equitable and in the public interest cannot be made." (emphasis ours) (Reply Brief Of California Grocers Association And Certified Grocers Of California, Ltd., As Amicus Curiae, pp.12-13, filed December 5, 1966)

Thriftimart, Inc., also replied to the briefs of the plaintiff and the consenting defendants in support of the second proposed consent decree, and although a defendant in the case at bar, it would appear from the following language of its brief that Thriftimart fully aligned itself with the "Users":

"Equally important, if not more important, is the fact that the consenting defendants cannot destroy the Blue Chip Stamp Company through the means of the Consent Decree without being guilty of fraud with respect to all of the grocers who relied upon their representations at the organization of Blue Chip and which representations were made repeatedly throughout the years to the present time.

"The grocers relied on these representations and acquired to the extent of their reliance and the extent of the representations an equitable interest

in the business of Blue Chip as equitable members of a de facto co-operative." (emphasis ours) (Reply Of Defendant Thriftimart, Inc. To Argument Of The Sperry And Hutchinson Company, Plaintiff And The Consenting Defendants, p.19, ll.22-32, filed December 6, 1966)

Thriftimart went on to state:

"It was on the basis of these representation oft repeated that the grocers of California came into the Blue Chip plan in order that they might remain competitive with those having the Sperry and Hutchinson franchised S & H green stamp. All went into the program. They made it a success. It was the money of the members as much as the backing of the stockholders that made possible Blue Chip and saved the grocery industry from monopoly. These facts, among others, are the background for the position of Certified Grocers and the California Grocers Association that they have a beneficial interest in this company. (emphasis ours) (Reply Of Defendant Thriftimart, Inc. To Argument Of The Sperry And Hutchinson Company, Plaintiff And The Consenting Defendants, p.24, ll.6-15, filed December 6, 1966)

After three days of oral argument, the Court refused to enter the second proposed consent decree. (Court Minutes of December 15, 1966) There can be no doubt as to Judge Ferguson's reasons for declining to sign the decree as is evidenced by his

following statement in a hearing on objections to a third proposed donsent decree:

"THE COURT: I have read it (third proposed consent decree) hundreds of times. Please don't make me go through it again.

"Answer my question, as a pragmatic service station operator, if you can convince me that this decree is going to do injury to you I probably won't sign it. But you are going to have to convince me on that level.

"MR. DOWNS: That's right.

"THE COURT: The grocery store people convinced me last time. Now if you, as a service station operator, can convince me this time more power to you. But you are not going to convince me on any other kind of approach." (insert and emphasis ours) (Reporter's Transcript of Proceedings of June 5, 1967, p.466 11.5-17)

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"THE COURT: There is a difference, there is a difference. Mr. Howland (Assistant State Attorney General) convinced me last time about the grocery stores." (insert and emphasis ours) (Reporter's Transcript of Proceedings of June 5, 1967, p.477, 11.12-14)

On April 28, 1967 a third proposed consent decree was lodged with the Court. This, of course, was the Consent Decree which was eventually signed on June 5, 1967 and thereafter put into

operation. (Amended Complaint, paragraph VI, R.4) It was pursuant to paragraph V of said Consent Decree (R.22), in which the defendants were ordered to present to the Court within 60 days a plan of reorganization of Blue Chip Stamp Company, that the defendants filed and had approved the plan of reorganization (R.35) containing the offer to "Users".

All of the parties and aforementioned amici curiae approved the Consent Decree. Certain other amici curiae objected to it (e.g. Independent California Service Station Operators, Gold Bond Stamps, etc.). In reply to their objections, the plaintiff-government commented on the considerations which had been involved in drafting the third proposed consent decree:

> "The proposed Final Judgment lodged with the Court on April 28, 1967 was agreed to by the United States only after long and complicated negotiations extending over two years. In drafting this decree, earnest consideration was given to the views of the Court expressed on December 15, 1966. Oral and written views of counsel for defendants, the State of California, Certified Grocers' Association, and the California Grocers' Association, all of whom approve the proposed decree, were received and considered by the Department of Justice, as well as the views of all parties interested in opposing the decree. (Plaintiff's Memorandum In Reply To Memorandum Filed In Opposition To Proposed Final Judgment Lodged With The Court April 28, 1967, p.5, ll.12-21, filed May 26, 1967)

In seeking Court approval of the Reorganization Plan and in defense of their "bargain offering" to "Users", the defendants stated:

> "...The Reorganization Plan has two basic purposes and objectives, namely: (1) To divest control of the company by the present stockholders and broaden the base of ownership so as to dissipate the alleged (and denied) combination and restraint, and (2) to compromise disputed claims which had been asserted by representatives of California Grocers' Association, Certified Grocers, and others in behalf of non-stockholder users. While the existence of such an equitable interest has been denied, it can fairly be said that the claims which had been so asserted were such that the Board of Directors of Blue Chip could properly and in good faith determine that they were worthy of being compromised." (emphasis ours) (Reply To Memorandum Of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan Of Reorganization Of Blue Chip Stamp Company Lodged With The Court August 3, 1967, p.9, ll.3-17, filed August 22, 1967)

If it is not clear from the above, it is manifestly so from the following, that the present defendants recognized the "right" or equitable interest of the "Users" and incorporated them into the plan of reorganization and Consent Decree:

> "There is the additional fact that a valuable

consideration moved from the Blue Chip shareholders to present Blue Chip which fully justifies its agreement to protect its shareholders, officers, and directors from liability. Certainly, it was and is in the interest of Blue Chip to settle the Government action without trial. It became apparent that such settlement could not be achieved without offering non-stockholder users an opportunity to acquire an equity interest at a price substantially equivalent to that originally paid by the present stockholders." (emphasis ours) (Reply To Memorandum Of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan Of Reorganization Of Blue Chip Stamp Company Lodged With The Court August 3, 1967, p.7, ll.7-18, filed August 22; 1967)

If there be any doubt that the Court, too, recognized this equitable interest in the "Users" and intended that it be accounted for in the Consent Decree, such doubt is allayed by the Court's following statement:

"The decree herein is designed to limit the powers of Blue Chip and to open up and increase competition in the stamp industry in California, while at the same time preserving the legitimate interests of the users of Blue Chip Stamps." (emphasis ours) (Order Denying Motions To Intervene And To Vacate Consent Decree, p.18, ll.6-10, entered August 8, 1967)

In addition, the very fact that the offering of securities to the "Users" was at a bargain price compels the conclusion that

the defendants recognized that the "Users" possessed the claimed equitable interest or right. Despite defendants' contentions to the contrary, there is no question, as well be seen infra, that the offering to the "Users" was intended to be and was, in fact, at a bargain".

In a hearing subsequent to Court approval of the Consent Decree and Plan of Reorganization, Mr. William W. Alsup on behalf of Blue Chip Stamps conceded that the "Users" were intended to be benefitted by the Consent Decree and plan of reorganization thereunder:

> "Mr. ALSUP: We do think we need a hearing date obviously to go into the question of who of these users are entitled to subscribe, assuming Mr. Raley and his group are not, and we take care of these users, as was intended." (emphasis ours) (Reporter's Transcript Of Proceedings, Monday November 4, 1968, Thursday, November 7, 1968, p.12, ll.8-12)

Furthermore, it was conceded that the offering was to be of substantial benefit to the "Users":

> "In our reply filed August 22, 1967 to the memorandum in opposition of Independent California Service Station Operators we discussed the financing arrangements available through the Bank of America and stated in part:
>
> ***
>
> "'If the service station operators are, even remotely, as unsophisticated financially as counsel

suggests, then if subscription rights were transferable there could be considerable danger they could be persuaded to give up their right to subscribe for a grossly inadequate price.

"'Certainly there is nothing illegal in restricting transferability of a rights offering and, since there is no restraint on the stock itself there is no restraint on alienation of property, i.e., the stock and debentures.

"'We cannot agree that the service station operators could be so lacking in time and financial sophistication that they will be unable to make a bank loan, and particularly so on an offering which it is conceded will be of substantial benefit to them.'" (emphasis ours) (Memorandum Of Blue Chip Stamps In Support Of Contention That The Raley's Options And Assignments Should Be Declared Invalid, pp.4-5, filed November 7, 1968)

The other party-litigant in the anti-trust litigation, the United States Government, through its counsel, Stanley E. Disney, Assistant U.S. Attorney, agreed with the assessment that the offering was a "bargain":

"MR. DISNEY: But on the basis of the record as it stands I think that many small users had made bad bargains and if there is any way to -- and I think that we intended in the decree to see that they got a good bargain." (emphasis ours)

(Reporter's Transcript Of Proceedings, Monday, November 4, 1968, Thursday, November 7, 1968, p.88, ll.1-4)

Again Mr. Disney pointed out the "bargain" aspect of the offering:

"MR. DISNEY: With reference to the decree, the intent of the decree he said that distributing 45% of the shares to users was intended basically to achieve two purposes. First to give the user the shares at bargain prices and hope that they would retain those shares; and secondly, by having a widespread distribution of the shares among the users to entrance the method in which the first and most important meeting of shareholders of Blue Chip Stamp took place." (emphasis ours) (Reporter's Transcript of Proceedings, supra, p.78, ll.9-17.)

At the same hearing, Mr. Wallace Howland on behalf of the State Attorney General sounded almost as if he had the present litigation in mind when he addressed the Court as follows:

"MR. HOWLAND: What we have here is a provision in the plan of reorganization that created and brought into existence a right or entitlement in the users of Blue Chip Stamps.

***

"And to make sure that the users knew of this right and entitlement there had been conferred upon them by the order of this court, the plan

then required advertisements in newspapers, and that a form on which the user could establish his usage would be sent out to all users, and that thirty days after the publication of the first such advertisement the right of users to establish their usage shall terminate.

***

"So what we have here, if the court please, is a right, a legally cognizable right conferred upon the user by the plan of reorganization proved by order of this court. It was a right, in effect, to compel Blue Chip Stamp Company to issue its units to a user, and it was a right that each user could either exercise or waive in his discretion." (emphasis ours) (Reporter's Transcript, supra, pp.41-43)

III. CONCLUSION

We therefore submit that it is clear from the foregoing exposition that: the "Users" emphatically asserted in the anti-trust action an equitable interest or right, that interest or right was recognized by the Court, the defendants, the government-plaintiff, and the various amici curiae on behalf of the "users," that interest or right was intended to be and was in fact incorporated in the Consent Decree and Plan of Reorganization thereunder, and that the "Users" must be afforded the appropriate relief under Section 10(b) in protection of that interest or right.

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Thus, we respectfully request that this Court reverse the Order below and permit this matter to be heard on its merits.

Respectfully submitted,

Dated: August 15, 1972

Brandlin, Ryan & McAllister

By: /s/ James E. Ryan
James E. Ryan

Attorneys For Plaintiff-Appellant

AFFIDAVIT OF SERVICE BY MAIL

STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

MARSHA JONES, being duly sworn, deposes and says: that her business address is 10960 Wilshire Boulevard, Los Angeles, California 90024; that she is a citizen of the United State and over the age of 18, employed in the County of Los Angeles, California, and not a party to this cause; that on August 15, 1972 she served a copy of the Supplemental Brief on the following parties:

O'Melveny & Myers
Attn: Thomas J. Ready
611 West Sixth Street
Los Angeles, California

McCutchen, Black, Verleger & Shay
Attn: G. Richard Doty
3435 Wilshire Boulevard
Los Angeles, California

Securities Exchange Commission
Jerry W. Markham
Washington, D.C.

Said service was accomplished by depositing a copy of said Affidavit enclosed in a sealed envelope, addressed to each party with the postage thereon fully prepaid, in a mailbox regularly maintained by the Government of the United States at 10960 Wilshire Boulevard, Los Angeles, California 90024.

Marsha Jones

Subscribed and sworn to
before me this 15th day of August, 1972.

Notary Public in and for said County and State

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In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74–124

BLUE CHIP STAMPS, ET AL., PETITIONERS

v.

MANOR DRUG STORES, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

QUESTION PRESENTED

The Commission will discuss the first question presented in the petition: Whether a party who neither purchased nor sold securities has standing to seek damages for injuries caused it by a violation of the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 thereunder.

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Commission is primarily responsible for the administration and enforcement of the federal securities laws, including the Securities Exchange Act of 1934. Private actions by the victims of securities

562-833—74——1

frauds, however, are a "necessary supplement" to the Commission's enforcement activities. *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 382; *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432. The Commission is concerned that the courts do not adopt restrictive constructions of the securities laws and of the Commission's rules that would weaken the protections they afford investors.

To further this objective the Commission as *amicus curiae* in private actions has argued consistently that the right to recover damages for violations of the broad antifraud provisions of Rule 10b–5, authorized by Section 10(b) of the Securities Exchange Act, should not be limited to actual purchasers and sellers of securities but should extend to all investors and potential investors. The Commission believes that this case presents the question in clear form and is therefore an appropriate occasion for this Court to resolve this important issue in the administration of the securities laws.

STATEMENT

In December 1963 the United States filed a civil antitrust action against Blue Chip Stamp Co. and nine of its twelve stockholders.[1] The complaint charged that the defendants had conspired to restrain and had monopolized the trading stamp business in California. In addition to Blue Chip, the defendants were major

[1] This statement of facts is taken from the opinion of the court of appeals and from the complaint filed by Manor Drug Stores. Because the district court granted petitioners' motion to dismiss the complaint, its factual allegations must be accepted as correct. *Conley* v. *Gibson*, 355 U.S. 41.

California retailers who used Blue Chip stamps and who collectively owned 90 percent of Blue Chip stock. The suit was settled in 1967 by a consent judgment. See *United States* v. *Blue Chip Stamp Co.*, 272 F. Supp. 432 (C.D. Calif.).

The judgment provided that Blue Chip Stamp Co. would be merged into a new corporation, Blue Chip Stamps. Securities of the new corporation were to be offered, at "bargain" prices, to retail firms—including Manor Drug Stores, the plaintiff in this action—that had used Blue Chip stamps but had not owned stock in Blue Chip Stamp Co. Each of these retail firms was entitled to purchase securities in proportion to the amount of stamps it had used. The complaint of respondent Manor Drug Stores alleges that the securities were offered at a bargain in order to allow the users to share in the undistributed profits of Blue Chip Stamp Co.

The complaint asserts that the defendants (now petitioners) devised a scheme to dissuade the offerees, by means of misleading statements, from purchasing the securities. The apparent motivation for the scheme was that any securities not purchased in the "bargain" offer could be sold later on the open market by petitioners at a greater price, thereby increasing the assets of Blue Chip Stamps and the value of each share owned by the other petitioners. In order to discourage the offerees from purchasing the securities petitioners in the prospectus unduly emphasized certain "Items of Special Interest" that might adversely affect the value of the securities; the prospectus also contained inflated estimates of anticipated expenses. Because of these misleading representations certain offerees did

not purchase the securities. Although the offering price of the new securities was $101, the market value was alleged to be $315 at that time (Pet. App. A–4, E–12).

The district court dismissed the complaint on the basis of the so-called "*Birnbaum* rule," announced in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (C.A. 2), certiorari denied, 343 U.S. 956, which held that a person who is neither a purchaser nor a seller of securities has no cause of action under Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b–5 thereunder.

Respondents appealed, but before the appeal was decided another panel of the Ninth Circuit, in *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339, adopted the *Birnbaum* rule. A divided panel in the instant case accepted *Birnbaum* and *Mount Clemens* as controlling, but reversed on the ground that those cases did not involve a situation where the plaintiffs had a right to buy securities "at a fixed price and in a fixed amount" (Pet. App. A–10). The court held that the offering of securities in this case, in compliance with the antitrust decree, "served the same function as" a contract for the purchase or sale of securities and therefore supported a damages remedy for the nonbuying plaintiffs. A suggestion for rehearing *en banc* was rejected, five judges dissenting.

REASONS FOR GRANTING THE WRIT

The Commission agrees with the court of appeals that respondents, although neither purchasers nor sellers of securities, have standing to assert a claim

for damages under Section 10(b) of the Securities Exchange Act of 1934. The Commission believes, however, that the proper ground for this conclusion was not the court's distinction of *Birnbaum*, but that the *Birnbaum* rule itself is unsound and should be rejected.

The Commission urges this Court to review this case because the validity of the *Birnbaum* rule is a recurrent question that has confronted the courts of appeals for more than 20 years. The question was left open in *Securities and Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 467, n. 9; and *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13–14, n. 10; the courts of appeals are divided and inconsistent in their treatment of the problem. The *Birnbaum* rule reflects an approach at odds with the remedial manner in which the securities laws should be interpreted, and it denies redress to an entire class of investors who are victims of securities frauds.

1. Within the last decade and a half the antifraud provisions of the federal securities laws, and particularly Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 thereunder, have become major tools used to effect Congress' decision "to prevent frauds in the sale * * * [of] securities sold in interstate and foreign commerce and through the mails," Preamble, Securities Act of 1933 (48 Stat. 74), and "to prevent inequitable and unfair practices" in connection with such securities transactions, Preamble, Securities Exchange Act of 1934 (48 Stat. 881). This Court has rejected various restrictive constructions

and limitations of the antifraud provisions that might frustrate the congressional desire to eliminate deceptive practices. See *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151; *Superintendent of Insurance* v. *Bankers Life & Casualty Co., supra*; *Mills v. Electric Auto-Lite Co., supra*, 396 U.S. at 382; *Securities and Exchange Commission* v. *Capital Gains Research Bureau*, 375 U.S. 180, 195.

The *Birnbaum* rule is yet another such restrictive construction unjustified by the words or the purposes of the Act. Although there is a private right of action for damages caused by a violation of Rule 10b–5, *Affiliated Ute Citizens, supra; Bankers Life & Casualty Co., supra*, the *Birnbaum* rule operates to deny this remedy to an entire class of fraud victims, depriving them of the protection the securities laws were intended to afford. There are often misrepresentations the purpose or effect of which—as in the instant case—is to prevent the purchase or sale of securities. There is no reason why victims of a fraud who suffer a loss should be treated less favorably when the loss results from their failure to make a "bargain" purchase than when it results from making a purchase that turns out to be no bargain.

2. Nothing in the Act or in Rule 10b–5 justifies the *Birnbaum* rule. Both the Act and Rule prohibit fraud "in connection with the purchase or sale" of a security. By this language the Congress and Commission sought to prevent all deceptive acts or practices which could affect investment decisions; a fraud committed to induce an investor to refrain from purchasing securities affects investment decisions no less than one

committed as part of a completed purchase or sale. In both instances the purchaser—prospective in one case and actual in the other—has been victimized by fraud in a securities transaction, and that is the evil which Congress attempted to prevent in Section 10(b).

Indeed, this Court has rejected the basic premise of *Birnbaum*. *Birnbaum* held that Section 10(b) and Rule 10b–5 "extended protection only to the defrauded purchaser or seller" of securities, 193 F. 2d at 464, and, consequently, that a person who could not claim to be within either category did not state a claim upon which relief could be granted. In *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*, 404 U.S. at 12–13, however, this Court pointed out that Rule 10b–5 prohibits all "deceptive practices touching * * *" the purchase or sale of securities by investors, and rejected the assumption made in *Birnbaum* that Section 10(b) "was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs." 193 F. 2d at 464.

Birnbaum has also been undermined by those more recent decisions affording standing to nonbuyers for purposes of seeking an injunction. *Britt* v. *Cyril Bath Co.*, 417 F. 2d 433 (C.A. 6); *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F. 2d 540 (C.A. 2).[2] To the extent *Birnbaum* is a rule of "standing," its denial of standing is based on a narrow reading of the "pur-

[2] Cf. *Mount Clemens*, *supra*, 464 F. 2d at 341–342; *Landy* v. *Federal Deposit Insurance Corp.*, 486 F. 2d 139, 156 (C.A. 3), certiorari denied, 416 U.S. 960.

chase or sale" language of the Act and Rule. If this language does not prevent nonbuyers from seeking injunctions, it should not prevent nonbuyers from seeking damages.

3. There is a conflict among the circuits. One circuit has disapproved the *Birnbaum* rule; other circuits have adopted it, albeit with slightly different statements of its scope. The Court of Appeals for the Seventh Circuit has flatly rejected *Birnbaum*. *Eason* v. *General Motors Acceptance Corp.*, 490 F. 2d 654, 661, certiorari denied, 416 U.S. 960. The Courts of Appeals for the Second,[3] Third,[4] Fifth,[5] Sixth,[6] Eighth,[7] and Ninth[8] Circuits accept *Birnbaum*. The Courts of Appeals for the First,[9] Fourth, Tenth,[10] and District of Columbia Circuits have not faced the problem.

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[3] See, *e.g.*, *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F. 2d 963, certiorari denied, 399 U.S. 909. Cf. *International Controls Corp.* v. *Vesco*, 490 F. 2d 1334, certiorari denied, June 3, 1974, No. 73-1542.

[4] *Landy* v. *Federal Deposit Insurance Corp.*, 486 F. 2d 139, certiorari denied, 416 U.S. 960.

[5] See, *e.g.*, *Sargent* v. *Genesco, Inc.*, 492 F. 2d 750. Cf. *Hooper* v. *Mountain States Security Corp.*, 282 F. 2d 195, certiorari denied, 365 U.S. 814.

[6] *Simmons* v. *Wolfson*, 428 F. 2d 455, certiorari denied, 400 U.S. 999. Cf. *James* v. *Gerber Products Co.*, 483 F. 2d 944.

[7] See, *e.g.*, *City National Bank* v. *Vanderboom*, 422 F. 2d 221, certiorari denied, 399 U.S. 905.

[8] See, *e.g.*, *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339.

[9] *H. K. Porter Co., Inc.* v. *Nicholson File Co.*, 482 F. 2d 421, intimates that the circuit might follow *Birnbaum* were the issue squarely presented.

[10] The decision of the Court of Appeals for the Tenth Circuit in *Jensen* v. *Voyles*, 393 F. 2d 131, is sometimes cited as an adoption of the *Birnbaum* rule. See, *e.g.*, *Landy* v. *Federal De-*

This Court should resolve the conflict and reject the *Birnbaum* rule. The fact that some courts have referred to "difficulties of proof that would accompany abandonment of the rule," Pet. App. A–16, should not preclude an investor or potential investor from attempting to demonstrate, according to the ordinary assessment of damages, loss resulting from a violation of Rule 10b–5. We submit that the mechanical application of the *Birnbaum* rule excludes worthy claims as well as the unworthy, thereby denying a day in court to many of the class of potential investors the Act and Rule were intended to protect.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be granted.

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NOVEMBER 1974.

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posit Insurance Corp., *supra*, 486 F. 2d at 156. However, the court in *Jensen* merely held that defendants' false representations must have a relationship to plaintiff's purchase of stock in order for plaintiff to have a cause of action under Rule 10b–5.

U.S. GOVERNMENT PRINTING OFFICE: 1974

TOPICAL INDEX

	Page
Table of Citations	iii
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutory Provisions Involved	3
STATEMENT OF THE CASE	4
1. Allegations of the Amended Complaint	5
2. Decision of the District Court	11
3. Decision of the Court of Appeals	12
SUMMARY OF ARGUMENT	15
ARGUMENT	17
I. In Barring a Non-Purchasing, Non-Investor Offeree From Asserting a Claim for Damages the *Birnbaum* Doctrine Properly Delineates the Implied Private Right of Action Under Rule 10b-5 and Serves to Prevent a Direct Conflict with the Express Policy of the Securities Act of 1933.	17
A. The purchaser-seller rule as it has been developed denies standing to seek damages to a non-purchasing, non-investor offeree.	17
B. The decision of the court below effectively overthrows the purchaser-seller doctrine and cannot be limited to the facts of this case.	23

Page

C. Balancing the benefits against the detriments that would result from permitting non-purchasing, non-investor offerees to sue for damages indicates that respondent should be precluded from suing. 30

D. The *Birnbaum* doctrine serves to prevent a direct conflict between implied liability under the Securities Exchange Act of 1934 and the Securities Act of 1933's express policy of full disclosure. 36

II. To the Extent the Decision Below Gave Respondent Standing Under Rule 10b-5 Because of the Users' Alleged "Rights" Under the Decree, It Is Erroneous and Conflicts with Decisions Which Refuse to Permit a Non-Party to an Antitrust Consent Decree to Assert in a Separate Proceeding Rights Alleged to Derive From that Decree. 42

CONCLUSION 49

Appendix A: Portions of section 11 of the Securities Act of 1933, 15 U.S.C. § 77k. (1)

Appendix B: Excerpts from Schneider & Manko, *Going Public — Practice, Procedure and Consequences,* 15 VILL. L. REV. 283, 287-96 (1970). (6)

Appendix C: Excerpts from *Guides for Preparation and Filing of Registration Statements,* Securities Act of 1933 Release No. 4936, as amended. (21)

Appendix D: Excerpts from Wheat & Blackstone, *Guideposts for a First Public Offering,* 15 BUSINESS LAWYER 539, 560-62 (1960). (26)

Page

TABLE OF CITATIONS

Cases

Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) 18, 35

A. T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967) 21

Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952) 12, 19

Buckeye Coal & Ry. Co. v. Hocking Valley Ry., 269 U.S. 42 (1925) 46

City National Bank v. Vanderboom, 422 F.2d 221 (8th Cir.), *cert. denied*, 399 U.S. 905 (1970) 20, 35

Clement A. Evans & Co. v. McAlpine, 434 F.2d 100, 104 (5th Cir. 1970), *cert. denied*, 402 U.S. 988 (1971) 35

Coffee v. Permian Corp., 434 F.2d 383 (5th Cir. 1970), *cert. denied*, 412 U.S. 920 (1973) 21

Commerce Reporting Co. v. Puretec, Inc., 290 F. Supp. 715 (S.D.N.Y. 1968) 21

Control Data Corp. v. IBM Corp., 306 F. Supp. 839 (D. Minn. 1969), *aff'd sub nom. Data Processing Financial & General Corp.*, 430 F.2d 1277 (8th Cir. 1970) 43, 46, 48

Dahl, Inc. v. Roy Cooper Co., 448 F.2d 17 (9th Cir. 1971) 46

Data Processing Financial & General Corp. v. IBM Corp., 430 F.2d 1277 (8th Cir. 1970), *aff'g sub nom.* Control Data Corp. v. IBM Corp., 306 F. Supp. 839 (D. Minn. 1969) 43, 46

Page

Doman Helicopters, Inc., 41 S.E.C. 431 (1963) 38

Drachman v. Harvey, 453 F.2d 722 (2d Cir. 1972) .. 21

Eason v. General Motors Acceptance Corp., 490 F.2d 654 (7th Cir. 1973), *cert. denied,* 416 U.S. 960 (1974) 20

Equitable Life Assurance Soc. v. Brown, 213 U.S. 25 (1909) 5

Erling v. Powell, 429 F.2d 795 (8th Cir. 1974) 20

Escott v. BarChris Const. Corp., 283 F. Supp. 643 (S.D.N.Y. 1968) 38

Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1968), *cert. denied,* 394 U.S. 928 (1969) 33

Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 303 F.2d 527 (10th Cir. 1962) 33

Feit v. Leasco Data Processing Equipment Corp., 332 F. Supp. 544 (E.D.N.Y. 1971) 38, 40

Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951) 18

GAF Corp. v. Milstein, 453 F.2d 709 (2d Cir. 1971), *cert. denied,* 406 U.S. 910 (1972) 21

Greater Iowa Corp. v. McLendon, 378 F.2d 783 (8th Cir. 1967) 14

Greenstein v. Paul, 400 F.2d 580 (2d Cir. 1968) .. 20, 22

Haberman v. Murchison, 468 F.2d 1305 (2d Cir. 1972) 20

Herbst v. ITT, 495 F.2d 1308 (2d Cir. 1974) 35

Page

Iroquois Industries Inc. v. Syracuse China Corp., 417 F.2d 963 (2d Cir. 1969), *cert. denied,* 399 U.S. 909 (1970) 21

Janigan v. Taylor, 344 F.2d 781 (1st Cir.), *cert. denied,* 382 U.S. 879 (1965) 33

Kahan v. Rosenstiel, 424 F.2d 161 (3d Cir.), *cert. denied,* 398 U.S. 950 (1970) 22

Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946) 18

Landy v. Federal Deposit Insurance Corp., 486 F.2d 139 (3d Cir. 1973), *cert. denied,* 416 U.S. 960 (1974) 20

Lanza v. Drexel & Co., [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,826 (S.D.N.Y. 1970) .. 40

Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973) 38

Levine v. Seilon, Inc., 439 F.2d 328 (2d Cir. 1971) 33

Manor Drug Stores v. Blue Chip Stamps, No. C-5652, Calif. Sup. Ct., County of Los Angeles 49

Mills v. Electric Autolite Co., 403 F.2d 429 (7th Cir. 1968), *vacated on other grounds,* 396 U.S. 375 (1970) 38

Mitchell v. Texas Gulf Sulphur Co., 466 F.2d 90 (10th Cir. 1971), *cert. denied,* 404 U.S. 1004 (1971) 35

Mount Clemens Industries, Inc. v. Bell, 464 F.2d 339 (9th Cir. 1972) 13, 21

Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, (2d Cir. 1967) 22, 25, 32

Page

Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), *cert. denied,* 390 U.S. 951 (1968) 33

Nortz v. United States, 294 U.S. 317 (1935) 5

Opper v. Hancock Securities Corp., 367 F.2d 157 (3d Cir. 1966) 21

Rekant v. Desser, 425 F.2d 872 (5th Cir. 1970) 20, 21

Richland v. Crandall, 262 F. Supp. 538 (S.D.N.Y. 1967) 38

Rochez Bros., Inc. v. Rhoades, 491 F.2d 402 (3d Cir. 1974) 35

Sargent v. Genesco, Inc., 492 F.2d 750 (5th Cir. 1974) 20, 21

Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968), *cert. denied,* 395 U.S. 906 (1969) 22

SEC v. National Securities, Inc., 393 U.S. 453 (1969) 19, 22, 31

SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969) 32

Simmons v. Wolfson, 428 F.2d 455 (6th Cir. 1970), *cert. denied,* 400 U.S. 999 (1971) 20

Smallwood v. Pearl Brewing Co., 489 F.2d 579 (5th Cir. 1974) 21

Superintendent of Insurance v. Bankers Life and Casualty Co., 404 U.S. 6 (1971) 18, 22

Swanson v. American Consumers Industries, Inc., 475 F.2d 516 (7th Cir. 1973) 35

United States v. Armour & Co., 402 U.S. 673 (1971) 43, 45, 48

Page

United States v. ASCAP, 341 F.2d 1003 (2d Cir.), *cert. denied*, 382 U.S. 877 (1965) 46

United States v. Blue Chip Stamp Co., 272 F. Supp. 432 (C.D. Cal. 1967), *aff'd sub nom.* Thrifty Shoppers Scrip Co. v. United States, 389 U.S. 580 (1968) 12

United States v. Morgan, 118 F. Supp. 621 (S.D.N.Y. 1953) 29

Vanderboom v. Sexton, 422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970) 20

Universal Camera Corp., 19 S.E.C. 648 (1945) 39

Vine v. Beneficial Finance Co., 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967) 21

Zeligson v. Hartman-Blair, 126 F.2d 595 (10th Cir. 1942) 5

Statutes

Judicial Code, 28 U.S.C. § 1254(1) 2

Securities Act of 1933

§ 2(3), 15 U.S.C. § 77b(3) 31

10(a), 15 U.S.C. § 77j(a) 37

11, 15 U.S.C. § 77k 4, 39

11(b), 15 U.S.C. § 77k(b) 40

12, 15 U.S.C. § 77(*l*) 8, 40

17(a), 15 U.S.C. § 77q(a) 18

Securities Exchange Act of 1934

§ 3, 15 U.S.C. § 78c 26

Page

§ 10(b), 15 U.S.C. § 78j(b) ..... 3 *et seq.*

28(a), 15 U.S.C. § 78bb(a) 33

Rules and Releases

SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 ..... 3 *et seq.*

SEC Securities Act Release No. 4936, as amended, *Guides for Preparation and Filing of Registration Statements* (1968) 39

Miscellaneous

Boone & McGowan, *Standing to Sue Under Rule 10b-5*, 49 TEXAS L. REV. 617 (1971) 22, 34, 35

A. BROMBERG, SECURITIES LAW (1973) 18, 19, 34

Comment, *The Purchaser-Seller Rule: An Archaic Tool for Determining Standing under Rule 10b-5*, 56 GEO. L.J. 1177 (1968) 23

H. R. Rep. No. 85, 73d Cong., 1st Sess. (1933) 37, 38

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L. LOSS, SECURITIES REGULATION (1961, Supp. 1969) 19

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Memorandum for SEC as *amicus curiae* (filed Nov. 7, 1974) 34

MOORE'S FEDERAL PRACTICE (2d ed. 1974) 5

Page

Note, *Rule 10b-5: The Rejection of the* Birnbaum *Doctrine by* Eason v. General Motors Acceptance Corp. *and the Need for a New Limitation on Damages,* 1974 DUKE L.J. 610 ..... 22, 33, 35

Note, *The Controlling Influence Standard in Rule 10b-5 Corporate Mismanagement Cases,* 86 HARV. L. REV. 1007 (1973) 19, 22

Note, *The* Birnbaum *Rule Rejected: Will Analysis of Right to Bring Private Action Under § 10(b) be Simplified?,* 31 WASH. & LEE L. REV. 757 (1974) 22

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Ruder, *Current Developments in the Federal Law of Corporate Fiduciary Relations — Standing to Sue Under Rule 10b-5,* 26 BUSINESS LAWYER 1289 (1971) 23

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THIRTY-NINTH ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION (1973) 30

Wheat & Blackstone, *Guideposts for a First Public Offering,* 15 BUSINESS LAWYER 539 (1960) 39

No. 74-124

In The
Supreme Court of the United States

October Term, 1974

Blue Chip Stamps, et al.,

Petitioners,

v.

Manor Drug Stores, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONERS

OPINIONS BELOW

The majority and dissenting opinions of the court of appeals are set forth in the separate appendix at App. 133 through 153. The order of the court of appeals denying the petitions for a rehearing *in banc* and modifying the majority and dissenting opinions is set forth at App. 154 through 156. The opinions of the panel, as modified, are reported in 492 F.2d at 136. The opinion and order of the district court, reported in 339 F. Supp. at 35, is set forth at App. 123 through 131.

JURISDICTION

On October 15, 1973, a panel of the court of appeals entered its decision reversing the district court's dismissal of the amended complaint. The matter was ordered remanded for further proceedings. (App. at 142.) On October 26, 1973, a judge of the court of appeals extended the time for petitioning for a rehearing *in banc* and ordered the mandate stayed. Timely petitions for a rehearing *in banc* were then filed. On April 1, 1974, an order was entered denying the petitions and making minor changes in the panel's opinions. Five active circuit judges noted that they would have granted a rehearing *in banc*. (App. at 154-56.) On June 21 Mr. Justice Douglas extended the time for filing a petition for certiorari to and including August 15, 1974. The petition was filed on August 15 and the writ granted on November 11, 1974. The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Can a person who has never owned, purchased or sold securities bring an action under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 of the Securities and Exchange Commission for damages allegedly occasioned by his failure to purchase securities offered him?

2. Does permitting a suit for damages to be brought under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 of the Securities and Exchange Commission by a person who allegedly declined to purchase offered securities because of an unduly pessimistic prospectus irreconcilably conflict with the purposes of the Securities Act of 1933?

3. Can a person who is not a party to a federal antitrust consent decree assert in a separate action rights alleged to derive from that decree?

STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), provides in pertinent part:

> "§ 78j. Manipulative and deceptive devices.
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> ". . . .
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated by the Securities and Exchange Commission, provides as follows:

> "§ 240.10b-5 Employment of manipulative and deceptive devices.
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, is set forth in pertinent part as Appendix A to this brief at Br. App. (1) through (5).

STATEMENT OF THE CASE

Petitioners are Blue Chip Stamps, Blue Chip Stamp Company, and various corporations and individuals who were, respectively, shareholders and directors of Blue Chip Stamps.[1] Respondent Manor Drug Stores, and the members of the proposed class it seeks to represent, were users of Blue Chip's trading stamp service who were offered, but did not purchase, stock and debentures of Blue Chip Stamps. Respondent brought an action against petitioners for damages allegedly suffered by

[1] Petitioners, named defendants in this action, are Blue Chip Stamps, Blue Chip Stamp Company, Alexander's Markets, Lucky Stores, Inc., Market Basket, Purity Stores, Inc., Ralphs Grocery Company, Safeway Stores, Inc., Thriftimart, Inc., Thrifty Drug Stores Co., Inc., Vons Grocery Co., Robert E. Alexander, Donald A. Koeppel, Leonard H. Straus, William F. Ramsey, Robert E. Laverty, Richard Ralphs, John R. Niven and Fred Von der Ahe.

respondent and the members of the proposed class as a result of their failure to purchase the offered securities, which failure to buy was purportedly caused by an unduly negative prospectus.

The decision under review is a 2-1 ruling by a panel of the United States Court of Appeals for the Ninth Circuit. The panel majority reversed an order of the United States District Court for the Central District of California dismissing respondent's amended class action complaint for failure to state a claim upon which relief could be granted. The district court ruled that respondent lacked standing to assert rights allegedly created by an antitrust consent decree to which it was not a party. The district court also ruled that the respondent was not entitled to maintain an action under section 12 of the Securities Act of 1933, and under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 of the Securities and Exchange Commission, for damages allegedly occasioned by its failure to purchase the offered securities.

1. Allegations of the Amended Complaint.

Because the district court decided the matter on motions to dismiss, this brief assumes the truth of the material well pleaded averments of the amended complaint and its supporting exhibits, which are incorporated into the complaint by reference.[2] The facts there set forth are as follows:[3]

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[2] A motion to dismiss takes as true only material well pleaded allegations of the complaint; it does not take as true opinions or conclusions of the pleader, including opinions and conclusions regarding the construction or effect of operative documents annexed to the complaint. *E.g.*, *Equitable Life Assurance Soc. v. Brown*, 213 U.S. 25, 42-43 (1909); *Nortz v. United States*, 294 U.S. 317, 324-25 (1935); *Zeligson v. Hartman-Blair*, 126 F.2d 595, 597 (10th Cir. 1942); 2A MOORE'S FEDERAL PRAC-

In 1963 the government filed a civil antitrust action under the Sherman Act against Blue Chip Stamp Company and nine of its corporate shareholders. (App. at 8, 23.) In June of 1967 the action terminated with the entry of a consent decree. (App. at 8, 23-35.)[4] In accordance with one of the provisions of that decree defendants submitted to the antitrust court a plan for the reorganization of Blue Chip Stamp Company. (App. at 8-9, 40-51.) The plan was ultimately approved. (App. at 8, 36-39.)[5]

The reorganization plan provided, *inter alia,* for the reduction of the amount of Blue Chip stock owned by the shareholder defendants in the antitrust action. (App. at 10, 38.) It called for the organization of a new corporation, Blue Chip Stamps ("new Blue Chip"). (App. at 41-42.) Then Blue Chip Stamp Company ("old Blue Chip") was to be merged into new Blue Chip and a total of 621,600 shares of new Blue Chip common stock were to be issued to the stockholders of old Blue Chip. (App. at 40-43.) To reduce the holdings of the defendant stockholders in new Blue Chip the plan provided for an offering by new Blue Chip of another 621,600 unissued shares to users of old Blue Chip's trading stamp service, a smaller offering to Blue Chip's management, and the grant of stock options to key employees. (App. at 44-48.)

TICE ¶ 12.08 at 2265-69 (2d ed. 1974). The complaint makes statements regarding the exhibits to the complaint which are contradicted by those documents. Where these conflicts are relevant to a decision of the issues under review, this fact statement relies on the documents themselves.

[3] The amended complaint and its exhibits are set forth in the separate appendix at App. 4 through 122.

[4] The June 5, 1967, consent decree was Exhibit A to the amended complaint and is reprinted in the separate appendix at App. 23 through 35.

[5] The plan of reorganization and the order approving it formed part of Exhibit B to the amended complaint and are reprinted in the separate appendix at App. 36 through 51.

The 621,600 shares to be offered to users of old Blue Chip's trading stamp service were not to be sold alone: They were to be part of a package, or "unit", and the number offered to each user was to be proportional to past stamp usage. (App. at 6, 44-47.) Each unit consisted of a $100 principal amount 6½% subordinated debenture maturing in 1978, and three shares of common stock. (App. at 9, 41, 44-45.) The offering price of a unit was to be $101. (App. at 9, 41.) The new Blue Chip debentures were subordinated to certain senior indebtedness and to various categories of existing and future legal claims and causes of action, including claims and actions against old Blue Chip, new Blue Chip or their officers, directors or shareholders, based on violations of the antitrust laws or arising out of the reorganization. (App. at 44-45, 80-81.)

In 1968 new Blue Chip was organized and made the offering to users described in the reorganization plan. (App. at 11-12.) More than half of the units were sold. (App. at 12.) Respondent and the users it purports to represent could have purchased a portion of the units in the offering, but did not do so. (App. at 18.)[6]

Two years after the offering, on November 10, 1970, this case was initiated by a complaint filed in the United

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[6] Neither the plan nor the antitrust court's order provided that "[a]ny of the 621,600 shares not purchased by the non-stockholding users were to be sold on the open market," as the court of appeals' opinion erroneously states (App. at 136), and as the amended complaint alleges. (App. at 9-10.) For the provisions of the order and plan respecting unsold shares, see App. at 38, 49.

The order approving the plan did provide that all the shares distributed in connection with the reorganization were to be freely alienable, and it contemplated that the shareholder defendants might sell some or all of their shares. (App. at 37-38.) A large number of the shares received by the shareholder defendants were sold in 1969. *See* p. 9, *infra*.

States District Court for the Central District of California but never served. (App. at 1, R. 1-17.) The amended complaint and the exhibits thereto, filed January 27, 1971, and later served, set forth the foregoing facts. The amended complaint contends that respondent and the members of the alleged class have suffered injury by reason of their failure to purchase the offered units, and seeks damages.

Although the amended complaint contains four "causes," respondent seeks recovery under essentially two theories. The first theory is found in causes one, two and three. These purport to state claims for relief under section 12 of the Securities Act of 1933, 15 U.S.C. § 77*l*, section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5.

In claim one, respondent avers that "several" nonstockholder users of old Blue Chip's trading stamp service "appear[ed]" before the antitrust court and contended that they "owned an interest in" old Blue Chip and profits it had accumulated and that in any decision of the government action the users' ownership of an interest in Blue Chip "should be decreed." (App. at 10.) These contentions allegedly "prompted" the provisions of the reorganization plan providing for an offering to users, and that offering allegedly was intended to be and was in fact a bargain designed to "benefit" the non-shareholder users. (App. at 10-11.) Respondent avers that "[t]he reasonable market value" of the units was and is "at least" $315.00, of which $75.00 represents one subordinated debenture and $80.00 represents each share of stock. Accordingly, "[t]he net bargain provided by said offering was . . . approximately $71.33 per share or $214.00 per unit." (App. at 11.)

Respondent alleges that old Blue Chip, new Blue Chip and the stockholders and directors named in the amended complaint desired that respondent and the members of the class it purports to represent not "exercise their rights" under the consent decree and plan "to purchase the shares to which they were entitled." (App. at 13.) In furtherance of this desire, petitioners allegedly caused the preparation of a conservative — or "negative" — prospectus[7] which disparaged the value of units. (App. at 13-17.)

Specifically, respondent complains that on the second page of the prospectus there was set forth, under the heading "Items of Special Interest", an index and summary of items of a negative nature which were discussed in full elsewhere in the prospectus. (App. at 13-15, 56.) When some of the petitioners sold their own shares[8] in a secondary offering over a year later (without combining them with subordinated debentures), no such list of items was included in the new prospectus.[9] (App at 15.)[10] Re-

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[7] The August 29, 1968, prospectus was Exhibit C to the amended complaint and is reprinted in the separate appendix at App. 55 through 90.

[8] An examination of the complaint and the supporting documents shows the court of appeals to have erred in suggesting that the shares later sold may have been the same shares offered in 1968 as part of the units. (App. at 137 n.7.) The shares offered in 1969 were owned by the selling shareholders themselves, not Blue Chip Stamps. (App. at 15, 100-01, 108.)

[9] The November 10, 1969, preliminary prospectus for the secondary offering was Exhibit D to the amended complaint and is printed in the separate appendix at App. 91 through 122.

[10] The statement in the court of appeals' opinion that the second prospectus "made no reference" to the items on this list is incorrect. (App. at 137.) A comparison of the allegations of the complaint with the factual recitations in the two prospectuses shows that respondent alleges the *list* was absent in the second prospectus, not that the items listed went unmentioned. (App. at 15, 56, 91-122.) They were, in fact, discussed in the second prospectus, although that discussion reflected sub-

spondent further complains that the discussion in the first prospectus of the various matters referred to in the list was unduly negative in that it called undue attention to the payment of some $7.9 million in settlement of legal claims and causes of action during the preceding six months, and the pendency of an additional $29 million in claims and causes of action (to which the debentures were subordinated); to the consent decree's prohibition against service by old Blue Chip directors on new Blue Chip's board; to the decree's requirement that Blue Chip offer for sale one-third of its trading stamp business in California; and to actual and possible loss of patronage by users and the fact that Blue Chip had no assurance of continued patronage. (App. at 14.) It is also alleged that the prospectus overestimated the percentage of Blue Chip's stamps that would ultimately be redeemed, and that this resulted in an understatement of earnings on stamp sales. (App. at 16-17.)[11]

Respondent contends that it and the members of the class it purports to represent did not buy any units because they were defrauded through the use of the first prospectus. (App. at 18.) Respondent seeks to recover as damages the difference between the $101 offering price of the unpurchased units and the alleged "reasonable market value" of $315. This $214 per unit totals $21.4 million in damages for respondent's alleged class. (App. at 12, 18.) Also sought are the right to buy the offered but unsold units at the 1968 offering price, attorneys' fees, interest, and $25 million in punitive damages. (App. at 22.)

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sequent events and the fact that the second offering did not involve debentures subordinated to antitrust and other claims. (App. at 96-99, 100-02, 103-04, 108-09.)

[11] If the first prospectus were inaccurate in this regard, so then was the second prospectus: They both used the same estimated redemption rate of 97.5%. (App. at 66, 99.)

The amended complaint's second and third causes reassert the averments of the first cause. In the second cause, respondent makes the additional allegation that petitioners acted with actual fraudulent intent. (App. at 19.) In the third cause, respondent contends merely that the petitioners lacked a "sufficient or reasonable" grounds for believing the "false and misleading representations" in the prospectus to be true. (App. at 20.)

Respondent's second theory of liability is found in the amended complaint's fourth cause, a pendent claim. It reasserts the averments of the first cause and adds the allegation that respondent and the class it purports to represent were "the express intended beneficiaries of said final consent judgment entered into between the [United States] and [the defendants in the antitrust action] . . .", that the consent judgment "stated that defendants planned a reorganization of [old Blue Chip]", that the reorganization was to be conducted in good faith, and that the petitioners' alleged misrepresentations were "a violation of the Court imposed duty of good faith and constituted a breach of said Final Consent Judgment." (App. at 21.) Cause four seeks the same relief as causes one, two and three. (App. at 21.)

2. Decision of the District Court.

The district court granted petitioners' motions for an order dismissing the amended complaint with prejudice for failure to state a claim upon which relief could be granted. With respect to the fourth cause, the court ruled that respondent, who had not been a party to the government antitrust suit and consent decree,[12] lacked standing

[12]The non-shareholder users of old Blue Chip's stamp service were not parties to the antitrust action. Several non-parties did appear before the antitrust court as *amici curiae*. Attempts by some users and others to intervene after entry of the

to sue for breach of the terms of the antitrust court's judgment or to assert rights alleged to derive from that decree. (App. at 125-27.)

As for the first three causes, the district court held that the statutes and rule relied upon by respondent did not give it a cause of action. Section 12 of the Securities Act of 1933 expressly limits recovery to "purchasers" of securities, something which respondent claims not to be. (App. at 127.) And, the court stated, under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 a party may sue for damages only if it has entered into a transaction "having the effect of a purchase or sale of securities." (App. at 130.) Since respondent did not enter into any such transaction, it could not state a claim. (App. at 127-30.)

3. Decision of the Court of Appeals.

Respondent appealed to the United States Court of Appeals for the Ninth Circuit on all aspects of the district court's ruling. (App. at 132.) The matter was briefed, argued and, on March 2, 1972, submitted to a panel consisting of Judges Browning, Hufstedler and Choy. On March 17 the panel vacated the submission and requested that the SEC file a brief as an *amicus curiae*. The SEC submitted a brief, advocating complete abandonment of the rule founded upon the decision in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952). As it has developed, the so-called "*Birnbaum* rule" provides that a private litigant may sue for damages under rule 10b-5 only if he can be considered to have been a purchaser or seller

consent decree for the purpose of having the decree vacated were denied. *United States v. Blue Chip Stamp Co.*, 272 F. Supp. 432 (C.D. Cal. 1967), *aff'd sub nom. Thrifty Shoppers Scrip Co. v. United States*, 389 U.S. 580 (1968).

of securities. Both petitioners and respondent filed briefs directed to the SEC's arguments, and the matter was resubmitted.

On July 20, 1972, the panel requested that the parties and the SEC file memoranda directed to the effect on this case of the unanimous decision by another panel of the circuit in *Mount Clemens Industries, Inc. v. Bell,* 464 F.2d 339 (9th Cir. 1972) (Chambers, Koelsch and Ely, JJ.). That decision adopted the *Birnbaum* rule in the Ninth Circuit and denied permission to sue to a non-purchasing, non-selling non-investor. The parties and the SEC filed memoranda and the matter stood submitted in the fall of 1972.

The panel handed down its decision on October 15, 1973. Judge Browning, writing for himself and Judge Choy, reversed the district court and remanded the matter for further proceedings.

In finding that the respondent had standing to sue for damages the majority reasoned as follows: The purpose of section 10(b) of the 1934 Act and rule 10b-5 is to protect the purity of stock transactions against manipulative and deceptive practices such as are alleged by respondent, and it is irrelevant to this purpose that a purchase or sale never actually occurred. Under the allegations in the complaint, the court concluded, injunctive relief would have been available if timely sought by the SEC or a party with sufficient interest. Since a violation of the rule was alleged, should respondent be barred from suing for damages solely because it did not purchase? The majority answered this question in the negative.

The requirement that a plaintiff in a damage action be a purchaser or seller, the majority asserted, rests on

considerations other than whether the conduct alleged was within the scope of the statute's and the rule's purpose; it rests on the assumption that unless a plaintiff alleges that he purchased or sold the stock involved in the fraud, his chances of proving his case are too slight to allow the action to proceed. (App. at 138-40.) This assumption is usually justified because of the lack of objective evidence regarding causation and damages. (App. at 140-41.) However, the majority noted that plaintiffs who have been parties to a contract to purchase or sell securities have been allowed to sue for damages, notwithstanding the absence of a consummated purchase or sale. It concluded that even though respondent could not have enforced the consent decree, if the allegations of the complaint concerning the decree and its intentions are taken as true, the decree "serves the same function" as a contract to purchase.[13] It increases the respondent's apparent ability to prove its causation and damage claims sufficiently to satisfy what the majority saw as the purpose of the purchaser-seller requirement. (App. at 141-42.)[14]

Judge Hufstedler, in dissent, said the majority's ruling misconceives the policy underlying the purchaser-seller

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[13] The majority opinion as originally written used the phrase "served as the functional equivalent" of a contract to purchase. (App. at 141.) However, the order denying rehearing *in banc* altered this phrase to "serves the same function as". (App. at 154-55.) This change in wording appears to be without substantive significance.

[14] The ruling of the district court with respect to respondent's claims under section 12 of the 1933 Act, which the court of appeals did not mention, was correct. The civil liability provisions of section 12 *expressly* limit those who can bring actions for damages to actual purchasers. Thus, no right of action is created in favor of one, such as respondent, who alleges only that it did not purchase securities. *Greater Iowa Corp. v. McLendon*, 378 F.2d 783, 790 (8th Cir. 1967) (Opinion of Gibson, J., joined by Blackmun and Mehaffy, JJ.)

doctrine. (App. at 146-48, 149-53.) Further, she observed that unless the majority rejects the established rule denying non-parties to antitrust consent decrees standing to sue on those decrees, the decree in no way sets the users apart from any other person who is offered but does not purchase securities. (App. at 145-46 & n.3, 148-49.) Thus, the majority's decision amounts to a rejection of the purchaser-seller rule in any case where a plaintiff can plausibly allege causation and damages. (App. at 146-47 n.4.) This result, she noted, invites damage actions brought by non-participants in the market who simply watch from the sidelines and risk nothing, and it places an almost impossible burden on prospectus draftsmen. (App. at 152-53.)

On November 5, 1973, petitioners sought a rehearing *in banc*. Respondent and the SEC filed briefs opposing the petition; on April 1, 1974, it was denied. Judges Koelsch, Ely, Hufstedler, Trask and Wallace noted their votes to rehear the case *in banc*. The order denying the rehearing also made minor changes in the opinion of the panel majority and in the dissent. (App. at 154-56.)

This Court granted certiorari on November 11, 1974.

SUMMARY OF ARGUMENT

For at least two reasons the decision of the court of appeals is erroneous.

First, it rejects the long-standing rule that a private plaintiff seeking damages for a violation of section 10(b) of the Securities Exchange Act of 1934 and SEC rule 10b-5 must be a purchaser or seller of securities. This purchaser-seller rule has been developed to give definition to the judicially implied private right of action under 10b-5 and represents sound policy. The reasoning of the

court of appeals throws over that rule and would permit any non-purchasing, non-investor offeree to state a claim under 10b-5 for the recovery of the difference between the price at which he was offered, but declined to buy, securities and the amount the securities subsequently appear to have been worth at the time of the offer.

Granting a right of action to a non-purchasing, non-investor offeree cannot be justified when the benefits to be gained are weighed against the effects of the almost limitless resulting liability and the tremendous potential for abuse. And where, as here, the complaint charges that the offer in question was made *via* a prospectus required by the Securities Act of 1933, and that the prospectus was too pessimistic because it emphasized adverse contingencies to which the company and the securities were subject, permitting a non-purchasing offeree to seek damages for his lost "bargain" undercuts the 1933 Act's policy of requiring full disclosure of all adverse facts and contingencies to potential investors. Adherence to the purchaser-seller rule in this circumstance prevents a direct conflict between the implied right of action under rule 10b-5 and express provisions of the Securities Act of 1933.

Second, the court of appeals erred to the extent it attempted to limit its decision to the facts of this case by relying on the amended complaint's allegations that the respondent and its alleged class were intended beneficiaries of the antitrust consent decree. The respondent and the other non-shareholder users of Blue Chip's trading stamp service were not parties to that decree and are not express beneficiaries under the terms of either the decree or the plan of reorganization. But even if these non-parties are permitted to show that the antitrust court *intended* to benefit them, that would not serve to distinguish them from all other non-purchasing offerees for

the purposes of determining their right to bring an action under rule 10b-5. The established rule is that non-parties to a consent decree cannot, even if they are express beneficiaries of the decree, derive any rights from that decree and cannot sue, directly or indirectly, to enforce the decree. To distinguish respondent, because of its claim to be a beneficiary of the decree, from other non-purchasing offerees attempting to sue under rule 10b-5 for the benefit of some lost bargain is completely inconsistent with and will frustrate the strong policy considerations that underlie the Department of Justice's program for ending most antitrust actions through consent judgments.

In both the foregoing respects the court of appeals departed from established authority and reached a result that cannot be supported by sound policy. For these reasons, petitioners ask that the decision below be reversed.

ARGUMENT

I.

IN BARRING A NON-PURCHASING, NON-INVESTOR OFFEREE FROM ASSERTING A CLAIM FOR DAMAGES THE *BIRNBAUM* DOCTRINE PROPERLY DELINEATES THE IMPLIED PRIVATE RIGHT OF ACTION UNDER RULE 10b-5 AND SERVES TO PREVENT A DIRECT CONFLICT WITH THE EXPRESS POLICY OF THE SECURITIES ACT OF 1933.

A. The purchaser-seller rule as it has been developed denies standing to seek damages to a non-purchasing, non-investor offeree.

Section 10(b) of the 1934 Act and rule 10b-5 do not expressly provide a private civil right of action for harm

suffered as a result of conduct prohibited by the section and rule. The courts, however, have long implied such a cause of action. *E.g., Fischman v. Raytheon Mfg. Co.,* 188 F.2d 783 (2d Cir. 1951); *Kardon v. National Gypsum Co.,* 69 F. Supp. 512 (E.D. Pa. 1946). And this Court has recognized the existence of an implied right of action for damages. *Superintendent of Insurance v. Bankers Life & Casualty Co.,* 404 U.S. 6, 13 n.9 (1971); *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 150-54 (1972).

Because section 10(b) and rule 10b-5 do not provide for private civil liability, they do not set forth the "elements" of the cause of action, nor do they clearly designate the persons who are entitled to assert that cause, or describe the circumstances under which various remedies may be available. For these reasons, and because of the sweeping language of 10(b) and 10b-5, the courts have developed various doctrines to define the 10b-5 cause of action. Principal among these is the purchaser-seller rule.

In determining what class of persons should be permitted to bring an action for damages under section 10(b) and rule 10b-5 the legislative history of the section has provided little assistance to the courts. What history there is indicates that section 10(b) was viewed simply as a residual antifraud provision. There is no indication that Congress thought it was creating a private civil right of action under the section. *See* 1 A. Bromberg, Securities Law § 2.2 at (300)-(340) (1973); Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?* 57 Nw. U.L. Rev. 627, 642-60 (1963).

However, rule 10b-5 does have some administrative history. It was promulgated in 1942 under authority of section 10(b). Its language is almost entirely derived from section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a). In promulgating the rule the SEC did not con-

template that it would play a role in private actions. 10b-5 had a rather narrow purpose of closing a loophole in the various antifraud provisions the SEC administered by extending prohibitions on fraud to all purchasers of securities. *Birnbaum v. Newport Steel Corp., supra,* 193 F.2d at 463; 3 L. Loss, SECURITIES REGULATION at 1469 & n.87 (1961); 6 L. Loss, *supra,* at 3617 (Supp. 1969); 1 A. BROMBERG, *supra,* § 2.2 at (410)-(420).

During the initial stages of the judicial evolution of private civil liability under rule 10b-5, *Birnbaum v. Newport Steel Corp.,* 193 F.2d 461 (2d Cir. 1952), was decided. The Second Circuit refused to permit non-purchasing, non-selling shareholders complaining of a breach of fiduciary duty by corporate insiders to sue for damages under section 10(b) and rule 10b-5. It reasoned that the section and rule were not intended to reach breaches by corporate officers of their fiduciary duties, but only to prohibit that type of fraudulent conduct usually associated with purchases and sales of securities. And the declared purpose of the SEC in promulgating the rule was the narrow one of extending prohibitions previously limited to broker-dealers. Therefore, the court concluded, 10b-5 "extended protection only to the defrauded purchaser or seller." 193 F.2d at 464. Since the plaintiffs did not fall within either category, they were denied standing to sue.[15]

Although the somewhat narrow reading *Birnbaum* gave to the type of conduct reached by the rule has been abandoned, *see* Note, *The Controlling Influence Standard*

[15]The term "standing" has been used repeatedly to describe whether one may maintain a private action under 10b-5 for damages. This use of the term does not refer to Article III "case or controversy" standing, but to the more general concept of who should be entitled to bring an action for a specific type of relief and have his claim adjudicated on the merits. *See SEC v. National Securities, Inc.,* 393 U.S. 453, 467 n.9 (1969).

in Rule 10b-5 Corporate Mismanagement Cases, 86 HARV. L. REV. 1007, 1016-20 (1973), the decision's "purchaser-seller" rule has been followed over the intervening 22 years. The Second Circuit has repeatedly reaffirmed that one may not bring an action for damages allegedly occasioned by a violation of 10b-5 unless he is a purchaser or seller of securities. *E.g., Greenstein v. Paul*, 400 F.2d 580, 581 (2d Cir. 1968), *Haberman v. Murchison*, 468 F.2d 1305, 1311 (2d Cir. 1972). And the Third, Fifth, Sixth and Eighth Circuits have all joined the Second Circuit on this point. *E.g., Landy v. Federal Deposit Insurance Corp.*, 486 F.2d 139, 156-57 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *Rekant v. Desser*, 425 F.2d 872, 879 (5th Cir. 1970); *Sargent v. Genesco, Inc.*, 492 F.2d 750, 763 (5th Cir. 1974); *Simmons v. Wolfson*, 428 F.2d 455, 456 (6th Cir. 1970), *cert. denied*, 400 U.S. 999 (1971); *City National Bank v. Vanderboom*, 422 F.2d 221, 227-28 (8th Cir.), *cert. denied*, 399 U.S. 905 (1970); *Vanderboom v. Sexton*, 422 F.2d 1233, 1243 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970); and *Erling v. Powell*, 429 F.2d 795, 799-800 (8th Cir. 1970).

The Seventh Circuit has said it has rejected the *Birnbaum* rule and permitted an non-purchasing, non-selling *investor* to sue for damages under rule 10b-5. *Eason v. General Motors Acceptance Corp.*, 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 416 U.S. 960 (1974) (Burger, C.J., Douglas and White, JJ., dissenting from denial of certiorari; Powell, J., not participating.)[16]

[16] In *Eason* the plaintiffs were investors who held shares in a corporation and who had executed personal guarantees of notes in connection with the issuance of 7,000 shares of their corporation's stock to one of the defendants. They asserted their 10b-5 claims in response to a suit by a defendant on the guarantees. On these facts it could be argued that there is substantial question as to whether *Eason* is actually inconsistent with the line of authority requiring a plaintiff to be classifiable as a purchaser or seller of securities. But in any event, the plaintiffs in *Eason* were *investors*, unlike the respondent here.

No circuit has followed *Eason* and the Fifth Circuit has recently reaffirmed its adherence to *Birnbaum*, rejecting *Eason* in the process. *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 590 (5th Cir. 1974); *Sargent v. Genesco, Inc.*, 492 F.2d 750, 762-64 (5th Cir. 1974).

Despite the fact that its demise has been announced by some commentators,[17] and repeatedly sought by the SEC,[18] the purchaser-seller rule retains its vitality. The courts have read the terms "purchase" and "sale" so as to maximize the protection of investors and those trading in securities. Those who are parties to contracts for the purchase or sale of securities have been permitted to sue for damages under 10b-5, although no purchase or sale was actually consummated. *E.g., Opper v. Hancock Securities Corp.*, 367 F.2d 157 (3d Cir. 1966); *A.T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967); *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715 (S.D.N.Y. 1968). Where the fraud alleged has occurred in connection with a transaction having the effect of involuntarily forcing a sale by an investor or converting his securities to a claim for cash, the courts have allowed standing to seek damages without requiring the formal act of selling. *See, e.g., Vine v. Beneficial Finance Co.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967); *Coffee v. Permian*

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[17] *E.g.*, Lowenfels, *The Demise of The Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268 (1968).

[18] Since at least 1967 the SEC, in briefs *amicus curiae*, has attacked the purchaser-seller rule and sought its elimination. It has been uniformly unsuccessful. *See, e.g., Vine v. Beneficial Finance Co.*, 374 F.2d 627, 636 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967); *Iroquois Industries Inc. v. Syracuse China Corp.*, 417 F.2d 963, 967 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970); *Rekant v. Desser*, 425 F.2d 872, 879 (5th Cir. 1970); *GAF Corp. v. Milstein*, 453 F.2d 709, 721 (2d Cir. 1971), *cert. denied*, 406 U.S. 910 (1972); *Drachman v. Harvey*, 453 F.2d 722, 736, 738 (2d Cir. 1972) *(in banc); Mount Clemens Industries, Inc. v. Bell*, 464 F.2d 339, 341 (9th Cir. 1972).

Corp., 434 F.2d 383, 385-86 (5th Cir. 1970), *cert. denied*, 412 U.S. 920 (1973). And a plaintiff who is a shareholder, but not a purchaser or seller of securities, may bring a derivative damage action on behalf of his corporation upon alleging it purchased or sold securities. *See, e.g., Schoenbaum v. Firstbrook*, 405 F.2d 215 (2d Cir. 1968) *(in banc), cert. denied*, 395 U.S. 906 (1969); *cf. Superintendent of Insurance v. Bankers Life and Casualty Co.*, 404 U.S. 6 (1971).

Non-purchasing, non-selling shareholders have been permitted by some courts to bring actions under 10b-5 for injunctive relief from fraud which, if successful, would harm a shareholder. But in so ruling the courts have drawn a distinction between actions seeking injunctive relief and actions seeking damages. *See Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 546-47 (2d Cir. 1967); *Greenstein v. Paul*, 400 F.2d 580, 581 (2d Cir. 1968); *Kahan v. Rosenstiel*, 424 F.2d 161, 173-74 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970); *cf. SEC v. National Securities, Inc.*, 393 U.S. 453, 467 n.9 (1969).

Analytical precision may not be the hallmark of the large body of cases that establish the broad outline of the purchaser-seller doctrine; however, those decisions do effectively define the limits of that doctrine and show its continuing strength and flexibility.[19] *Birnbaum* grounded the purchaser-seller rule largely on the SEC's original

[19] For descriptions of the present dimensions of the purchaser-seller rule see, *e.g.*, Boone & McGowan, *Standing to Sue Under SEC Rule 10b-5*, 49 TEXAS L. REV. 617, 623-49 (1971); Note, *Rule 10b-5: The Rejection of the* Birnbaum *Doctrine by* Eason v. General Motors Acceptance Corp. *and the Need for a New Limitation on Damages*, 1974 DUKE L.J. 610, 616-17 n. 35 (1974); Note, *The Controlling Influence Standard in Rule 10b-5 Corporate Mismanagement Cases*, 86 HARV. L. REV. 1007, 1017-18 n.49 (1973); Note, *The* Birnbaum *Rule Rejected: Will Analysis of Right to Bring Private Action Under § 10(b) be Simplified?*, 31 WASH. & LEE L. REV. 757, 759-65 (1974).

purpose for promulgating rule 10b-5, but in its present form the rule also serves to place reasonable limits on the broad exposure to damage liability that has developed under the section and rule. The purchaser-seller rule has been criticized primarily on grounds that it does not permit sufficient opportunity for shareholders to challenge action, such as mismanagement, that may have reduced the value of their securities. *See, e.g.*, Ruder, *Current Developments in the Federal Law of Corporate Fiduciary Relations — Standing to Sue Under Rule 10b-5*, 26 BUSINESS LAWYER 1289 (1971); Comment, *The Purchaser-Seller Rule: An Archaic Tool for Determining Standing Under Rule 10b-5*, 56 GEO. L.J. 1177 (1968); Kellogg, *The Inability to Obtain Analytical Precision Where Standing to Sue Under Rule 10b-5 is Involved*, 20 BUFF. L. REV. 93 (1970). The cases making injunctive relief available to non-purchasing, non-selling investors seem to be a movement in that direction. But while commentators have called for erosion of the purchaser-seller rule for the benefit of shareholders, it has not been seriously contended that the purposes of the Act and rule require the extension of standing to sue for damages to a non-purchasing, non-selling non-investor, such as respondent. *See, e.g.*, Comment, *supra*, 56 GEO. L.J. at 1186-87 & nn.68 & 69.

The decision of the Ninth Circuit here stands alone in abrogating the purchaser-seller doctrine and enunciating a rule that permits a non-purchasing, non-investor offeree to bring a damage action under 10b-5.

B. The decision of the court below effectively overthrows the purchaser-seller doctrine and cannot be limited to the facts of this case.

The court of appeals majority attempted to create the impression that its decision was not a departure from

existing purchaser-seller authority. It reasoned from the injunction cases that the justification for the purchaser-seller rule in damage actions rests

> "largely on the assumption that if plaintiff does not allege that he purchased or sold the stock involved in the fraud it is evident at the outset that his claim must fail 'both on proof of loss and the causal connection with the alleged violation of the Rule.' *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 547 (2d Cir. 1967). *See also Britt v. Cyril Bath Co.*, 417 F.2d 433, 435-36 (6th Cir. 1969); *cf. Rekant v. Desser*, 425 F.2d 872, 881 (5th Cir. 1970); Boone & McGowan, *Standing to Sue Under SEC Rule 10b-5*, 49 Texas L. Rev. 617, 646 (1971); Kellogg, *The Inability to Obtain Analytical Precision Where Standing to Sue Under Rule 10b-5 Is Involved*, 20 Buffalo L. Rev. 93, 114-16 (1970).
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> "This assumption is usually justified. Ordinarily there will be little proof (other than the non-purchaser's own opinion, after the loss) that the non-purchaser would in fact have purchased but for the fraud, and, if so, how much, when, or at what price; also, generally, the potential number of non-purchasers will be without definable limit. But this is not invariably true." (App. at 140-41.)

The majority said that standing to sue for damages has been allowed to "non-purchasers or non-sellers" when a contract to purchase or sell exists, and it suggested that this was due to the fact that contracts

> "often furnish objective evidence of the reality of a plaintiff's intention to purchase or sell but for the fraud, and thus of causation. They may also fix the price, quantity, and time of sale, thus making it possible to calculate damages. And the existence of such

> contracts permits a reasonable circumscription of a defendant's potential liability by identifying from among the limitless number of possible non-purchasers those few that the defendant chose to deal with himself. *See Commerce Reporting Co. v. Puretec, Inc., supra,* 290 F. Supp. at 719." (App. at 141.)

The majority concluded that "[u]nder the allegations of this complaint, the consent decree involved here serves the same function as" the contractual relationship found in other cases granting standing to sue because it fixed the terms of the offering and gave respondent "a right to buy" a portion of the offered securities. (App. at 141, 155.) The complaint's allegation as to the price at which some of the petitioners later sold some of their stock was seen as fixing an "objective measure of the amount of loss," and the allegation that the offering to users was at a price far below the true worth of the securities was seen as supporting an inference that "users properly informed rather than misled would have accepted the offer." (App. at 142; footnote omitted.) These allegations, then, were thought to reduce the speculativeness of respondent's claim enough to satisfy the purpose of the purchaser-seller rule.

The majority's reasoning is patently defective. First, although it may well be true that one who has purchased or sold securities has a less speculative claim than one who has not, this is hardly the sole justification for the purchaser-seller requirement in damage cases. The court in *Mutual Shares Corp. v. Genesco, Inc.,* 384 F.2d 540, 547 (2d Cir. 1967), did suggest that absent a purchase or sale, loss and causation will necessarily be difficult to prove. But as Judge Hufstedler pointed out, the ability to *allege* a purchase or sale says little about one's ability to *prove* the elements of one's case. (App. at 145, 147.) The

difficulty of proof suggested by *Mutual Shares* is only one factor supporting the purchaser-seller doctrine. *See* pp. 31-36, *infra*. Second, standing is allowed in cases involving contracts to purchase or sell securities not because the contract makes the plaintiff's allegations "non-speculative", but because the 1934 Act specifically defines the terms "purchase" and "sale" to include a contract to purchase or sell.[20] Finally, and most important from the standpoint of the decision's impact, the consent decree does not reduce the "speculative" nature of respondent's claims. The non-purchasing users are factually indistinguishable from any other class of persons who did not accept an offer to purchase securities in the course of an offering made to an identifiable group at a fixed price.

In finding the complaint's averments sufficiently non-speculative the majority purports to rely in part on the allegation that the consent decree gave respondent and other users a "right" to purchase the offered securities.[21] As Judge Hufstedler stated in her dissent,

> "the [users'] ability to prove causation and damages cannot be likened to that of parties who have contracted to buy or sell. Their situations are dissimilar because a contract creates legal rights between the parties. [The users] had no duties and no rights created by the consent decree. The decree could not have been enforced against them, and they could not

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[20] Sections 3(a)(13) and (14) of the 1934 Act, 15 U.S.C. § 78c (13) and (14), provide as follows:

> "(13) The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire.
>
> (14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

[21] The majority's attempt to distinguish this case on the basis of the complaint's allegations concerning the intention of the consent decree is dealt with in Part II hereof, pp. 42 through 49, *infra*.

have enforced it, even if the parties to the action resulting in the decree had intended to benefit them specifically. [Citations omitted.] Because the consent decree creates no rights or duties in [the users], their commitment and ability to purchase the offered securities are far less definite than in a case in which a contract binds the parties. This want of definiteness renders [the users] far less able to prove causation and damages than those who have contracted to buy securities and negates the 'same function' conclusion that is the basis for the majority's grant of standing." (App. at 145-46, 155.)

The majority suggests that respondent is prima facie able to prove causation because the complaint alleges that under the consent decree and plan the units were a bargain, and, therefore, it can be inferred that any informed offeree would have bought. And the majority further suggests that respondent has sufficiently alleged an objective measure of damages by citing a price at which individual shares were sold over a year after the offering.[22] Neither allegation can serve to set the members of

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[22]The complaint appears to base its allegation of the "true" value of the units by reference to the $90 per share price (adjusted for an intervening 5 for 1 split) at which stock sold a year later. (App. at 15, 142.) And the measure of the alleged bargain is based on an assertion that the debenture was worth $75 and, therefore, that the price of the three shares was $8.67 each. (App. at 11, 18.) This is hardly an "objective" measure of the respondent's claimed loss. The units were only partially composed of stock; the other portion of the units was a $100 face amount, ten year debenture subordinated to many substantial risks, including antitrust claims against Blue Chip and possible claims under the indemnification agreements. P. 7, *supra*. The complaint alleges nothing which would serve as an "objective" justification for its allocation of the price of a unit among its components. Given the contingencies to which the debentures were subject, this seems necessary since the value of the debentures could, as a result, easily have been far less than $75, and the portion of the price attributable to the

the alleged class apart insofar as the speculative character of their claim is concerned. For any non-purchasing, non-selling offeree could allege that the securities he had an opportunity to buy were worth far more than he thought, that he would have known this fact had the defendant made a full and accurate disclosure, and that the measure of his damages, and the proof of true value and of causation, is the fact that the particular securities sold later at a higher price.

Thus, in satisfying the majority's "same function" test the consent decree and plan of reorganization fixed nothing more than the quantity of shares offered, the price, the time of sale and the general description of the offerees.[23] The first three of these are fixed in any offering of securities for sale. And in almost any situation an identifiable person or group of persons could be found (or alleged) who had an opportunity but failed to purchase offered securities.[24]

An example of a typical securities transaction that offers ample opportunity for application of the majority's "same function" test may be useful. A common method of distributing new securities is to employ underwriters. The principal underwriters arrange to purchase the

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shares, far more. In the present case, then, the complaint cannot be said to rely for an "objective" value on a subsequent transaction involving the same securities.

Insofar as the value of the stock alone is concerned, the complaint only mentions the alleged price over a year after the offering to users. But the second prospectus states that very shortly after the offering to users shares of new Blue Chip, severed from the debentures, sold in the market place at from $10 to $20 per share. (App. at 96 (adjusted for split).)

[23]The class of offerees here included at least 20,000 retailers who were users of Blue Chip's trading stamp service in 1968. *See* App. at 59, 64.

[24]Although this case is concerned with offers to sell, unaccepted offers to buy would also seem to provide a basis for a damage claim under the majority's reasoning.

issuer's securities and distribute them. Before the securities are issued they approach selected other members of the National Association of Securities Dealers and offer them an opportunity to participate in the distribution by agreeing to take varying amounts of the new issue. If the NASD member believes the securities are worthwhile, it will agree to take a number of shares, perhaps in some circumstances for its own account. The participating underwriters will attempt to sell the bulk of the securities to the investing public, typically contacting regular customers and offering them shares. Sometimes this offering to customers will be done before the registration process is completed and will amount to an offer to sell "when issued." By this type of transaction, of which there are infinite variations, billions of dollars in new securities are offered each year.[25]

The majority's rule would have a pervasive effect on such normal underwriting transactions. At the wholesale and retail level identifiable persons will be offered securities for purchase. Should it subsequently happen that the issue was underpriced and rose rapidly upon issuance,[26] any offeree could claim he had an opportunity to buy at a set price and upon set terms, that he did not appreciate the true value of the securities because of some unduly negative statement or some failure to reveal affirmative facts, that he would have

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[25] This is a simplistic description of the underwriting process. For a detailed discussion of the variety of transactions used to bring securities to the investing public by underwriting, see Judge Medina's lengthy opinion in *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953). For discussion of the distribution and selling process, see Schneider & Manko, *Going Public – Practice, Procedure and Consequences*, 15 VILL. L. REV. 283, 287-96 (1970). (Portions of this article are reprinted as Appendix B to this brief at Br. App. (6) through (20).)

[26] For a discussion of why issues may be priced below the probable market price, see Schneider & Manko, *supra*, Br. App. at (10).

bought had he known the "bargain" nature of the offer, and that as a result he was wrongfully deprived of the "profit" he would have made had he bought. Or he might as easily allege he bought *less* of the offered securities than would have been the case had he not been misled. Here is "same function" at a level that confounds the imagination. And the impact upon the securities marketing system of such a rule would be enormous. In 1973 alone over $27 billion in new corporate securities were registered with the SEC for immediate cash sale; the value of all registrations exceeded $59 billion. THIRTY-NINTH ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION 163-66 (1973). Yet, as Judge Hufstedler said, there is no way to distinguish the respondent and its alleged class from other disappointed offerees, except that "their disappointment can be assuaged for no more than $21,000,000, rather than many times that amount." (App. at 149.)

Under the rule established by the majority, the *only* time one would have to have purchased or sold securities to obtain standing to sue for damages would be when he lacks the minimal creativity necessary to allege in a complaint facts that would bring his claim within the "same function" analysis or otherwise give it some surface appearance of non-speculativeness.

C. Balancing the benefits against the detriments that would result from permitting non-purchasing, non-investor offerees to sue for damages indicates that respondent should be precluded from suing.

When the language and purposes of the 1934 Act are considered and the detrimental effects of the ruling below are weighed, it becomes clear that standing to sue for damages should not be granted to non-purchasing, non-investor offerees.

In the context of a claim of standing by a non-investing offeree, the language of the rule and section are helpful in determining their intended reach. The limiting phrase in both is "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5; *see SEC v. National Securities, Inc.*, 393 U.S. 453, 465-68 (1969). The 1934 Act defines purchase or sale to include contracts to purchase or sell or otherwise dispose of. *See* p. 26, *supra*. That definition does not include an *offer* to purchase or sell. The parallel definitional section in the Securities Act of 1933 defines "sale" in much the same terms as the 1934 Act. *See* § 2(3), 15 U.S.C. § 77b(3). However, it separately defines "offer" as something distinct from a sale. Had Congress intended section 10(b) to reach offers, it knew how to accomplish that purpose. The failure to include simple offers within the terms of section 10(b) can be taken to indicate that they were not within the section's grant of authority to the SEC. Therefore, neither the section nor the rule should be extended to reach the situation alleged in the complaint.

This reading of the section and rule is confirmed by further analysis. The private cause of action asserted is wholly a judicial creation; therefore, the policies underlying the section and rule must be carefully considered to determine if the standing sought will, in view of its deleterious effects, substantially further those policies. If not, it should be denied. Generalizations about the protection of potential investors and maintaining the purity of stock transactions such as were relied upon by the court below help little in making this judgment.

Cases which have struck the balance differently depending on the status of the plaintiff and the nature of the remedy sought include those allowing injunctive actions by investors who have neither purhased nor sold.

It appears from those decisions that whatever the arguable semantic reach of the rule and section, the courts have concluded that an injunctive remedy ought to be available to a non-buying, non-selling investor, while a damage remedy ought not because of the problems it may present and the unlimited scope of the resulting liability. *See Mutual Shares Corp. v. Genesco, Inc., supra,* 384 F.2d. at 543-44. As Judge Hufstedler said of the majority's ruling below:

> "[E]xpansion of standing to bring suits for injunctive relief does not entail the risk of strike suits or of exposure to imponderable liability that expanded standing in damage actions threatens." (App. at 148.)

Permitting those with a present economic commitment to securities — investors — to sue for injunctive relief against wrongful conduct which would harm a selling investor seems an appropriate step. It permits the investor to act as a private attorney general to aid in enforcing the rule, and it avoids the anomalous result that one must await the consummation of the fraudulent conduct which threatens measurable harm and cannot sue to prevent it. At the same time, the prophylactic relief offered by an injunction is a relatively mild remedy in terms of its collateral effects upon legitimate activity. *See, e.g., SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 866-68 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) (concurring opinion of Friendly, J.).[27]

A damage remedy is a different matter, however. This is especially true when the party seeking damages is a

[27] No case has been found in which a plaintiff permitted to bring an injunctive action under 10b-5 was not at least an existing investor. Absent such a present interest in the securities in question, it seems unlikely that a plaintiff would be entitled to seek equitable prophylactic relief.

non-purchasing, non-selling *non-investor*. Testing the limits of the standing sought here against the purpose to be served and the effect it will have leads to the conclusion that it should be denied.

The supposed "injury" allegedly suffered by respondent and its alleged class is not one that cries out for compensation. Under the ruling below those who have never invested in, or made a legal commitment to the offered securities, as by purchasing or contracting to purchase, will be entitled to seek the profit they allegedly could have made had they accepted the offer, entered into the transaction and put their funds at risk. Despite the fact that they were never participants in the market, but sat on the sidelines watching for a period of time (here, two years) how the securities would do, they will be able to recover for their alleged "injury." The amount of the potential "profits" that could be sought *via* class actions for non-investors would be astronomical. And it could ultimately be paid out of the pocket of the company with which those who bought risked their funds. Note, *supra*, 1974 DUKE L.J. at 629-30.[28]

[28] There is a substantial question as to whether the harm allegedly suffered by respondent is compensible under section 28(a) of the 1934 Act, 15 U.S.C. § 78bb(a). "'Actual damages,' under the Federal rule of damages for fraud is the 'out of pocket rule.'" *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 533 (10th Cir. 1962). Such "liability does not include the expectant fruits of an unrealized speculation." *Id. See, e.g., Janigan v. Taylor*, 344 F.2d 781, 786 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965); *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), *cert denied*, 390 U.S. 951 (1968); *Esplin v. Hirschi*, 402 F.2d 94, 104 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); *Levine v. Seilon, Inc.*, 439 F.2d 328, 334 (2d Cir. 1971). Respondent has sustained no actual out of pocket loss because respondent had no contractual or other enforceable right to purchase at the offering price, and had given no consideration for the offer. P. 44 n.31, *infra*. The difference between the offering price and actual value at that time does not fit within the out of pocket rule. *Levine v. Seilon, Inc., supra*, 439 F.2d at 335.

Another factor weighing against a grant of standing to those such as respondent is mentioned by Judge Hufstedler:

> "The great ease with which plaintiffs can allege the requirements for the majority's standing rule and the greater difficulty that plaintiffs are going to have proving the allegations suggests that the majority's rule will allow a relatively high proportion of 'bad' cases into court. This risk of strike suits is particularly high in such cases; although they are difficult to prove at trial, they are even more difficult to dispose of before trial." (App. at 151 n.9.)

The potential for abuse inherent in the ruling is extremely high. Virtually any non-purchasing offeree will be able to state — although perhaps not prove — a claim on behalf of himself and a class by simply alleging that but for the defendant's wrongful activities, plaintiff and the members of its class would have purchased securities which were offered to them at a price below their true value. The fact that any non-purchasing offeree will be able to impose the costs and risks of possibly mammoth litigation on a defendant does not appear to trouble the SEC or the court below. They seem to think that the problem of the unmeritorious action will be resolved summarily during the course of litigation on the merits. (App. at 142); *see* Memorandum for SEC as *amicus curiae* at 9 (filed Nov. 7, 1974). This view is extremely unrealistic.

The few defined elements of a 10b-5 action have been substantially eroded over the years. *E.g.,* Boone & McGowan, *supra,* 49 Texas L. Rev. at 619-20; *see* 1 A. Bromberg, *supra,* § 4.7 at (500) *et seq.* This has facilitated the maintenance of large class actions creating much greater exposure to liability for defendants, and providing much less opportunity to test the meritorious

character of the plaintiff's case short of full trial. For example, while in one cause respondent has alleged intentional misrepresentations and omissions, in another it alleges simple negligence. (App. at 20.) A number of courts hold negligence a sufficient mental state for a finding of liability. *See, e.g., Clement A. Evans & Co. v. McAlpine,* 434 F.2d 100, 104 (5th Cir. 1970), *cert. denied,* 402 U.S. 988 (1971); *Mitchell v. Texas Gulf Sulphur Co.,* 446 F.2d 90, 102 (10th Cir.), *cert. denied,* 404 U.S. 1004 (1971); *City National Bank v. Vanderboom,* 422 F.2d 221, 229-30 (8th Cir.), *cert. denied,* 399 U.S. 905 (1970). Similarly, although respondent alleges it and the members of the alleged class relied on the negative prospectus, decisional law indicates that where an omission to state material facts is involved, actual reliance need not be shown. *See, e.g., Affiliated Ute Citizens v. United States, supra,* 406 U.S. at 153-54; *Herbst v. ITT,* 495 F.2d 1308, 1315 (2d Cir. 1974); *Rochez Bros., Inc. v. Rhoades,* 491 F.2d 402, 410 (3d Cir. 1974); *Swanson v. American Consumers Industries, Inc.,* 475 F.2d 516, 520-21, 523 (7th Cir. 1973). And the amended complaint alleges omissions. (App. at 13, 16-17.)

It should be plain that a non-purchasing, non-investor offeree will be able to state a broad class claim and easily avoid summary dismissal. It should be equally plain that the rule adopted below has tremendous potential for extortion. Regardless of the merits of the case, few if any defendants would be willing to run the risk that a finder of fact would decide that the elements of a claim had been proven and, on the basis of subjective evidence, that the plaintiffs would have bought had they known all the facts. *See. e.g.,* Boone & McGowan, *supra,* 49 Texas L. Rev. at 648-49; Note, *supra,* 1974 Duke L.J. at 624-31.

To some degree the problems set forth above are already present in 10b-5 class action litigation. *Id.*

However, the decision of the court below opens vistas of potential liability, and almost certain litigation, far beyond what exists under the purchaser-seller doctrine. These consequences surely do not serve the purposes of the section or the rule and argue strongly that extending standing to seek damages to non-purchasing, non-selling non-investing offerees is not worth the price. Judge Hufstedler made this point:

> "An expansive definition of the class given standing to pursue section 10(b) damage actions promises some incremental benefit in preventing deceptive practices in the marketing of securities, one of the principal purposes of the section. Expanding the class, however, entails costs as well as benefits. Incautious loosening of the purchaser-seller rule will generate federal litigation, increase the cost of marketing securities, inject into securities marketing new risk factors that defy accurate assessment, expose offerors to draconian damage claims, and invite strike suits. Securities markets are complex and sensitive institutions. Opening the valve, even a little, that controls the flow of section 10(b) damage actions can so far unsettle the market as to defeat, rather than to promote, the benevolent purposes of Congress in enacting the statute." (App. at 151-52; footnotes and citation omitted.)

D. The *Birnbaum* doctrine serves to prevent a direct conflict between implied liability under the Securities Exchange Act of 1934 and the Securities Act of 1933's express policy of full disclosure.

Perhaps the most important factor that weighs against granting standing to non-purchasing offerees such as respondent is the conflict that results between the 1934 Act

and the Securities Act of 1933 when the offer involved is one made pursuant to a 1933 Act prospectus.

The evil at which the 1933 Act was aimed was the then general practice of failing to disclose to investors adverse or potentially adverse material facts while emphasizing all positive facts, thus effectively "puffing" or overstating the value of offered securities. The House report that accompanied the House version of the Act stated the problem:

> "During the post-war decade some 50 billions of new securities were floated in the United States. Fully half or $25,000,000,000 worth of securities floated during this period have been proved to be worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise. Alluring promises of easy wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security. High-pressure salesmanship rather than careful counsel was the rule in this most dangerous of enterprises." H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933).

In response Congress enacted the registration and prospectus provisions of the 1933 Act, which require, *inter alia*, that all material facts be disclosed in a prospectus. *See* § 10(a), 15 U.S.C. § 77j(a). The House report described the sections specifying the contents of a prospectus as follows:

"The purpose of these sections is to secure for potential buyers the means of understanding the intricacies of the transaction into which they are invited. The full revelations required in the filed 'registration statement' should not be lost in the actual selling process. This requirement will undoubtedly limit the selling arguments hitherto employed. That is its purpose. . . . Any objection that the compulsory incorporation in selling literature and sales argument of substantially all information concerning the issue, will frighten the buyer with the intricacy of the transaction, states one of the best arguments for the provision. The rank and file of securities buyers who have hitherto bought blindly should be made aware that securities are intricate merchandise." H.R. Rep. No. 85, 73d Cong., 1st Sess. 8 (1933).

The courts and the SEC have made it plain that all material facts, including adverse contingencies, must be revealed. *See, e.g., Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973) (*in banc*); *Escott v. BarChris Const. Corp.*, 283 F. Supp. 643, 680-81 (S.D.N.Y. 1968); *Feit v. Leasco Data Processing Equipment Corp.*, 332 F. Supp. 544, 569-71 (E.D.N.Y. 1971) (collecting and analyzing the authorities). The adverse facts cannot merely be disclosed: They must be given emphasis sufficient to convey their importance and the risks they portend for the investor. *See Mills v. Electric Autolite Co.*, 403 F.2d 429, 434 (7th Cir. 1968), *vacated on other grounds*, 396 U.S. 375, 381 & n.4 (1970); *Richland v. Crandall*, 262 F. Supp. 538, 553-54 (S.D.N.Y. 1967); *Feit v. Leasco Data Processing Equipment Corp., supra*, 332 F. Supp. at 564-65. The SEC has held that a failure to emphasize pertinent risk factors in a prospectus and in a registration statement constitutes a material failure to comply with the disclosure requirements of the 1933 Act. *E.g., Doman Helicopters, Inc.*,

41 S.E.C. 431, 439 (1963); *Universal Camera Corp.*, 19 S.E.C. 648, 652, 654-56 (1945). See SEC Securities Act Release No. 4936, *Guides for Preparation and Filing of Registration Statements*, p. 6, ¶ 6 (1968).[29]

This requirement of disclosure and emphasis on adverse matters comports with Congress' purpose of protecting investors from issuers "puffing" the value of their securities by minimizing the risks inherent in their purchase. To assure that issuers refrain from transgressing the limits of this policy, Congress enacted, *inter alia*, section 11 of the 1933 Act, 15 U.S.C. § 77k.[30] This section permits a purchaser to sue the issuer for damages occasioned by a decline in the price of the purchased securities, without regard to reliance by the purchaser upon the prospectus. He need show no more than that the prospectus (which is filed with and constructively constitutes a portion of the registration statement) contains "an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." The non-negligence of the issuer is no defense to such an action.

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[29] The complaint's principal claims regarding the 1968 prospectus are that it gave emphasis to certain adverse contingencies to which the debentures and the company were subject by including a list of them on the second page of the prospectus. *See* pp. 8-10, *supra*. But SEC practice specifically requires such listings of risk factors for emphasis. *See* SEC Securities Act Release No. 4936, as amended, *Guides for Preparation and Filing of Registration Statements*, p. 6, ¶ 6 (1968) (portions of the *Guides* are reprinted as Appendix C to this brief at Br. App. (21) through (25)); Wheat & Blackstone, *Guideposts for a First Public Offering*, 15 BUSINESS LAWYER 539, 560-62 (1960) (portions of this article are reprinted as Appendix D to this brief at Br. App. (26) through (31)).

For a discussion of how the registration process works, see Schneider & Manko, *supra*, 15 VILL. L. REV. 283 (1970), Br. App. at (11)-(17).

[30] Relevant portions of this statute are contained in Appendix A to this brief, Br. App. at (1)-(5).

§ 11(b), 15 U.S.C. § 77k(b). "Section 11 creates almost absolute liability in the issuer." *Feit v. Leasco Data Processing Corp.*, 332 F. Supp. 544, 575 (E.D.N.Y. 1971) (citing authorities).

Substantially similar liability is imposed by section 11 upon inside directors of the issuer. "Their liability approaches that of the issuer as a guarantor of the accuracy of the prospectus." 332 F.Supp. at 578. *See also* § 12, 15 U.S.C. § 77*l* (liability of persons selling securities by means of the prospectus). And this standard of liability is supplemented by possibly broader but less stringent liability imposed under rule 10b-5. *See, e.g., Lanza v. Drexel & Co.*, [1970-71 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92, 826 (S.D.N.Y. 1970); *cf. Feit v. Leasco Data Processing Corp., supra*, 332 F. Supp. at 584.

The 1933 Act, then, forces a prospectus draftsman to disclose fully and to emphasize amply adverse contingencies. This necessarily requires that he make predictive judgments as to the future impact they may have on the offered securities and the business of the issuer. By couching his descriptions and predictions in conservative and cautionary terms, he can seek both to protect the issuer and its directors from liability under section 11, and to preclude the purchaser from buying without fully appreciating the risks of the investment. SEC practice specifically encourages such an approach to prospectus drafting. *See* pp. 38-39 and n.29, *supra*, and authorities there cited.

In the face of 1933 Act policy and practice, the court of appeals has held that one who does not purchase securities offered by means of a prospectus can sue for damages under rule 10b-5 and section 10(b) of the 1934 Act if he alleges that the adverse matters appear in hindsight to have been over-emphasized. Granting standing to such

a non-purchasing offeree is to confront the prospectus draftsman with an impossible task: (i) disclose and emphasize adverse contingencies, on pain of purchasers suing to recover for a disclosure which under-estimated the risks involved; and (ii) do not emphasize adverse contingencies, on pain of non-purchasers suing to recover damages for a disclosure which over-estimated the risks of the investment.

Judge Hufstedler stressed the dilemma created:

> "The accuracy of a representation with regard to a security is usually judged by hindsight; if the price of the security rises substantially, prior representations may seem unduly conservative; if it falls, too optimistic. Under the purchaser-seller rule, offerors can protect themselves against unforeseen impositions of liability by acting with judicious restraint when dealing with others; they need merely avoid inaccuracies that induce others to act. If passive 'investors' were also allowed to sue, such self-protective conservatism might prove suicidal, for an offeror would have to be micrometrically accurate." (App. at 151 n.8.)

Overturning the purchaser-seller rule in the context of an offering made pursuant to a 1933 Act prospectus increases the probability that a given prospectus will be overly optimistic, or at least will give less than full emphasis to adverse facts. In the final analysis, the investing public will receive less protection against "puffing" and issuers will have an immensely greater exposure to liability, an almost certain exposure to costly litigation. Neither exposure will be avoidable, as Judge Hufstedler observed.

> "To expand standing to nonsellers or to nonbuyers, like appellants, who have taken no affirmative action

of any kind in reliance upon alleged deceptive statements invites litigation that has nothing to do with protecting the integrity of the marketing of securities. The passive investor could always await market developments without any risk, claiming deception caused nonbuying if the value of the securities proved more promising than the offerors' glum predictions and deception caused nonselling if a rosier prospectus was followed by a market decline. Meanwhile, securities offerors would be hard pressed to find language for prospectuses that would be sufficiently neutral to avoid potential damage suits from bystanders." (App. at 152-53.)

In the situation presented here the purchaser-seller rule serves the legitimate function of harmonizing the 1933 and 1934 Acts. At the same time it protects the actual investor and provides a buffer zone within which a prospectus draftsman can work.

II.

TO THE EXTENT THE DECISION BELOW GAVE RESPONDENT STANDING UNDER RULE 10b-5 BECAUSE OF THE USERS' ALLEGED "RIGHTS" UNDER THE DECREE, IT IS ERRONEOUS AND CONFLICTS WITH DECISIONS WHICH REFUSE TO PERMIT A NON-PARTY TO AN ANTITRUST CONSENT DECREE TO ASSERT IN A SEPARATE PROCEEDING RIGHTS ALLEGED TO DERIVE FROM FROM THAT DECREE.

The decision of the court of appeals cannot be limited to its facts. The majority appears to have thought it found in the consent decree a basis for distinguishing respondent from other disappointed offerees. However,

to the extent that the grant of standing to respondent is based upon the complaint's allegations regarding the intention of the consent decree, it is in conflict with this Court's decision in *United States v. Armour & Co.*, 402 U.S. 673 (1971), and with the Eighth Circuit's decision in *Data Processing Financial & General Corp. v. IBM Corp.*, 430 F.2d 1277 (8th Cir. 1970), *aff'g sub nom. Control Data Corp. v. IBM Corp.*, 306 F. Supp. 839 (D. Minn. 1969).

The majority's opinion relies heavily upon the complaint's averments that under the consent decree the respondent had a "right" to purchase the securities offered, and that the court and government "intended" the offering to be a "bargain" to compensate the non-shareholder users for their "interest" in old Blue Chip's retained profits. All this was supposedly "prompted" by the arguments presented to the antitrust court by users who were not parties to the government case. (App. at 135-36, 141-42.)

But the consent decree does not mention the offering, and the plan of reorganization provides only that the units are to be offered to the users at a set price and upon certain terms. Neither decree nor plan mentions the alleged claims of the users to old Blue Chip's profits, decrees any "interest" of the users in Blue Chip, or states that the offering is intended to be, or will in fact be, a "bargain" offering. Therefore, the decree and plan do no more than identify the offerees and fix the terms of the offering.

In any event, the allegation that the offering was a bargain does not factually distinguish this case because any non-purchasing offeree could similarly allege that securities offered to him were really worth more than the asking price. And, of course, any non-purchasing offeree

who failed to take advantage of a "bargain" could allege causation as well as has respondent. *See* pp. 27-28, *supra.*

The only characteristic about respondent and its alleged class that might theoretically set them apart from the general run of non-purchasing offerees is the claim that the consent decree court intended the non-shareholder users to be the beneficiaries of the decree and to have "rights" under it because of their claim to an interest in old Blue Chip. However, these "rights" are simply conclusions of the pleader based on unsupported allegations as to the antitrust court's intention to benefit the respondent.[31] And to found the supposed "rights" on an allegation as to the unexpressed intention of the antitrust court is to misunderstand the nature of a consent decree.

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[31] The respondent's allegation that the so-called "rights" were in recognition of the users' claims is not supported by the record facts. The users were not parties to the antitrust action and the consent decree makes no adjudication respecting claims of the users or anyone else. (App. at 23-24.) Therefore, any claims the users had were unaffected by the consent decree. And it was not a condition of the unit offering that users accepting the offer must relinquish any claims. They would be completely free to assert them after purchasing the units. The offering cannot, then, be considered some sort of compensation or *quid pro quo* by which the users' alleged claims were exchanged for rights to purchase units.

At least one *amicus* submitted a paper to the antitrust court dealing squarely with that court's view of the users' claim to an equitable interest in Blue Chip. In a brief filed on behalf of Raley's Inc. by counsel for respondent here, it was adamantly stated:

> "[I]f the approximate 28,000 'potential stockholders' . . . had an equitable claim, they will still have it after they acquire the stock. There are no releases of any claim required as a condition for the purchase of the stock. In fact, there may be thousands of purchasers of Blue Chip stamps who purchased their stamps before March 1964, the earliest cutoff date for eligibility . . . . Does the purported 'equitable claim' to the assets of Blue Chip continue to exist in these individuals as well?
>
> "*But this Court has already expressed itself upon the lack of legal soundness of this so-called equitable claim.* The

In *United States v. Armour & Co.*, 402 U.S. 673 (1971), the government sought certain relief under the 1920 meatpackers' consent decree on grounds that it was necessary to effectuate the decree's purposes. In affirming a denial of the requested relief the Court held that consent decrees, unlike decrees entered after full litigation through judgment, cannot be said to have any purposes. Rather, the parties to the decree have purposes which are generally opposed to each other, and

> "the resultant decree embodies as much of those opposing purposes as the respective parties have the bargaining power and skill to achieve. For these reasons, the scope of a consent decree must be discerned within its four corners, and not by reference to what might satisfy the purposes of one of the parties to it. Because the defendant has, by the decree, waived his right to litigate the issues raised, a right guaranteed to him by the Due Process Clause, the conditions upon which he has given that waiver must be respected, and the instrument must be construed as it is written . . . ." 402 U.S. at 681-82 (footnote omitted).

Even assuming, contrary to *Armour*, that allegations of a consent decree's unexpressed intentions will support a claim by a plaintiff to beneficiary status under that decree, the policies underlying antitrust consent decrees preclude such a plaintiff from maintaining an action under the 1934 Act that it would not otherwise be entitled to bring. To grant respondent standing under 10b-5 is inconsistent with the established rule that a

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facts support this Court's opinion." Quoted in Reply to Plaintiff-Appellant's Supplemental Brief at 5-6 (filed Sept. 13, 1972). (The briefs submitted to the court of appeals are not part of the record here; however, they have been lodged with the Clerk of this Court at the request of the parties.)

non-party to a consent decree cannot sue to enforce the provisions of that decree, *e.g., Buckeye Coal & Ry. v. Hocking Valley Ry.*, 269 U.S. 42, 47-49 (1925); *United States v. ASCAP*, 341 F.2d 1003, 1007-8 (2d Cir.), *cert. denied*, 382 U.S. 877 (1965); *see, e.g., Dahl, Inc. v. Roy Cooper Co.*, 448 F.2d 17, 20 (9th Cir. 1971), and is in direct conflict with the Eighth Circuit's decision in *Data Processing Financial & General Corp. v. IBM Corp.*, 430 F.2d 1277 (8th Cir. 1970), *aff'g sub nom. Control Data Corp. v. IBM Corp.*, 306 F. Supp. 839 (D. Minn. 1969).

In *Control Data* claims were made by non-parties to earlier consent decrees that they were the intended recipients of benefits to flow from those decrees and had a right to relief if the defendant thwarted their realizing those benefits. The district court ordered the claims stricken from the pleadings.

The court reasoned that the Attorney General is the representative of the public in government antitrust suits, and under established authority only parties can derive rights from or sue to enforce a consent decree terminating a government action. The pro-consent decree policies underlying this rule also require that non-parties to decrees, even if direct and intended beneficiaries, be denied standing to do, through a separate suit bottomed upon the obligations imposed by the decree, what they could not do directly — enforce the decree. 306 F. Supp. at 845-48. The actions were ordered to proceed as though the decrees had never been entered. The court of appeals affirmed, having approved the district court's reasoning. 430 F.2d at 1278.

The decision below, to the extent it allows respondent standing under rule 10b-5 because of the alleged intent of the consent decree, permits exactly the indirect enforcement of a decree that was rejected in *Control Data*. The

reasons for denying non-parties the ability to assert rights alleged to flow from a consent decree are forceful. As Judge Hufstedler stated:

> "A persuasive rationale for refusing to accord nonparties standing to enforce a consent decree is that the potential exposure to litigation and to liability that a contrary rule would engender would seriously impair the settlement of litigation. The public interest in obtaining consent decrees outweighs the interest of the nonparty litigants in obtaining direct vindication of their private interests. Control Data Corp. v. IBM Corp. (D. Minn. 1969) 306 F.Supp. 839, 846. If administration of the antitrust laws would be ill served by allowing direct enforcement of consent decrees by third parties, it is difficult to understand how it would be better served by the creation of 'rights', like that created by the majority opinion, that permit indirect enforcement of the decrees." (App. at 145-46 n.3.)

To permit non-parties to assert rights allegedly arising as a result of consent decrees can only be destructive of the Department of Justice's program for terminating the vast majority of government antitrust actions *via* consent decree. If antitrust defendants, such as petitioners, cannot be assured that their liabilities under a negotiated decree will be limited to those agreed to by the parties to the action, then they will be much more reluctant to give up their right to litigate.

Moreover, defendants in hundreds of government actions have entered consent decrees over the years with the understanding that their liabilities were carefully circumscribed. (The *Control Data* court mentioned some 495 consent decrees that had been entered in the period 1944-1969. 306 F.Supp. at 846.) The decision below would

work a retroactive revision of those decrees by allowing non-parties to come forward and claim enforceable rights under them. Such a result denies due process to those who gave up their right to defend themselves in exchange for a negotiated decree. *See United States v. Armour & Co., supra,* 402 U.S. at 681-82; *Control Data Corp. v. IBM Corp., supra,* 306 F. Supp. at 846-48.

For the foregoing reasons the 10b-5 standing decision made with respect to respondent here cannot be limited in its scope by the presence of the consent decree.[32]

As is suggested by the court in *Control Data,* the respondent is not without avenues for presenting its alleged grievances regarding the manner in which the offering was made. The respondent might attempt to persuade the Antitrust Division of the Department of Justice that the decree has been frustrated by petitioners' alleged misconduct, and that corrective action should be sought by the government from the antitrust court.[33] Apparently the respondent chose not to attempt to convince the government of the correctness of its views regarding the decree. Or perhaps the attempt was made, but was unsuccessful.

Alternatively, respondent might have applied for leave to intervene in the antitrust case as a party to assert frustration of the decree's purposes. But it did not do so. Instead, respondent chose to commence this class action seeking damages under the federal securities laws, and a state court class action raising claims under California

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[32] The court of appeals statement that respondent had not appealed the dismissal of its pendent claim under the decree is incorrect. (*Compare* App. at 141 n.14 *with* App. at 132.) The district court correctly decided the point.

[33] The decree provides for a reservation of jurisdiction by the antitrust court to entertain applications by "any of the parties" for enforcement or modification of the decree, or to punish violations of it. (App. at 35.)

law. *Manor Drug Stores v. Blue Chip Stamps,* No. C-5652 in the Superior Court, County of Los Angeles.[34]

If the antitrust decree created any rights in the non-shareholder users, then the antitrust court is clearly the proper forum for respondent's claims. United States District Judge Warren J. Ferguson handled the government antitrust action and signed the consent decree. Because some of the provisions of the consent decree have not yet been implemented, the matter is still pending before Judge Ferguson. There can be no better forum for determining the "intention" of the court, parties and decree that terminated the lengthy antitrust proceeding.

CONCLUSION

For the foregoing reasons the decision of the court of appeals should be reversed and the district court's order dismissing the amended complaint reinstated.

Respectfully submitted,

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(Continued on following page.)

[34] The state action has been in abeyance pending disposition of the federal action.

Thrifty Drug Stores Co., Inc., Vons Grocery Co., Robert E. Alexander, Donald A. Koeppel, Leonard H. Straus, William F. Ramsey, Robert E. Laverty, Richard Ralphs, John R. Niven and Fred Von der Ahe.

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Appendix A

Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k

§ 77k. Civil liabilities on account of false registration statement.

(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue —

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or

valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

(b) Notwithstanding the provisions of subsection (a) of this section no person, *other than the issuer,* shall be liable as provided therein who shall sustain the burden of proof —

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this

subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and . . . .

* * *

(e) The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided,* That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted,

not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) of this section for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) All or any one or more of the persons specified in subsection (a) of this section shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

(Emphasis added in paragraph (b).)

Appendix B

[Excerpts from Schneider* & Manko,** GOING PUBLIC — PRACTICE, PROCEDURE AND CONSEQUENCES, 15 VILL. L. REV. 283, 287-96 (1970).]

SELECTION OF AN UNDERWRITER

Once the decision has been made to go public, the parties immediately face perhaps the most important decision to be made — selecting the managing underwriter. Investment banking firms vary widely in prestige, financial strength and ability to provide the various services which the company can expect. Some underwriters are not ordinarily interested in first offerings, while others handle very few issues other than first offerings. Some underwriters have particular stature and experience in specific industries. Underwriters may have pre-existing relationships with customers, suppliers or competitors of a prospective company going public, which can be both an advantage and a disadvantage from varying points of view. In short, a managing underwriter appropriate for one company may be wholly inappropriate for another.

In selecting the underwriters, advice should be obtained from experienced advisers who have a background in the area of public offerings. The company's attorneys, auditors and bankers may be helpful in making the selection. Some advisers, particularly underwriters them-

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selves, warn of dire consequences from "shopping" an offering, and suggest dealing with a single underwriter at a time. Opinions on this subject vary. There are some small and speculative offerings where the trick is to find any underwriter, and there may be little chance for selection. Additionally, among smaller underwriters, there may be a reluctance to evaluate, negotiate and otherwise develop an underwriting prospect unless the company is dealing exclusively with the particular firm at that time.

On the other hand, if the proposed offering is good enough to appeal to the larger underwriters, management may be best advised to select a few firms, possibly three to five, with which to begin preliminary discussions more or less simultaneously. If the offering has merit, the larger underwriters normally are most willing to spend time investigating the company to decide whether or not they wish to proceed, and thereafter to sell themselves and their proposal if they do wish to handle the transaction. It is important to deal in candor. Each prospective underwriter should be told that other underwriters are being considered. For offerings of genuine merit, this element of competition may well whet the appetite and stand the company in good stead. This is not to suggest, however, that a company should put itself in an auction, trying to get each bidder to top the others.

Finally, it must be stressed that price is not the sole element of comparison, nor is it necessarily advantageous for the stock to be sold for the very top dollar which any prospective underwriter will offer. If the initial offering price is set too high, the issue may have a poor reception and a weak after-market for some time to follow. Some underwriters will frankly advise the company to set the initial offering price slightly under the projected after-market price, perhaps 5 percent to 10 percent below,

simply to assure a good reception for the stock. For companies with a good history and earnings record, the proper pricing of the issue often must be determined by the market conditions prevailing at the offering date. Therefore, many underwriters will indicate during the preliminary negotiations the price, or price range, at which the offering could be made if it were being made at that time, with the express reservation that final pricing will be determined by prevailing conditions on the offering date which is normally at least a few months in the future. Thus, the managing underwriter is often selected at a time when the parties have not yet fixed the specific offering price.

Before the underwriters are selected, the company should investigate the after-market performance of the underwriters' prior offerings. Some companies go public only to find limited after-market interest following completion of the underwriting, with the result that the stock does not reach the price levels which the company projects on the basis of the performance of comparable issues. The managing underwriter should have a good record in forming syndicates which provide strong after-market interest and support for their offerings.

Several services can be expected from the underwriters. Initially, the managing underwriter will take the lead in forming the underwriting syndicate. The underwriters are also expected to provide after-market support for the security being sold. They may serve as over-the-counter market makers which stand ready to purchase or sell the stock in the inter-dealer market; they may purchase the stock for their own account; and they may take the initiative in bringing the stock to the attention of public investors, including their own customers. Ideally, the company should seek a managing underwriter which

customarily makes a continuous inter-dealer market for the issues it manages, although there are some managing underwriters that do not perform this function themselves.

In addition, the managing underwriter traditionally supplies other investment banking services to the company following the offering. They will assist in obtaining additional financing from public or private sources as the need arises, advise the company concerning possible acquisitions and generally make available their expertise as financial institutions. In many cases they will recommend or furnish experienced men to become members of the company's board of directors, or to serve as officers or key employees of the company.

All things considered, it is best for the company to select as manager the strongest underwriter willing to handle the offering, subject to an important qualification. If the company aims too high, and selects a firm which might consider the company an unimportant client, the underwriter may not have the necessary interest in the company and may not take the time to supply the follow-up services. Thus, for a relatively small offering, the company may do best with a relatively small firm or a strong regional firm based in its area, rather than a giant Wall Street firm. The company should be an important client to its investment banker, a client which will have top personnel assigned to it and receive the most prompt and effective service which the investment banker can render.

Structure of the Offering

Once a company has decided to make a public offering, it must determine, in consultation with its managing underwriter, what class of securities should be offered.

Most first offerings include common stock. Some first offerings consist of a package including other securities such as debentures, which may or may not be convertible into common stock, or warrants to purchase common stock. It is normally not practicable to have a publicly traded security convertible into common stock or a publicly traded warrant to purchase common stock unless a public market exists for the underlying common stock.

There are two other interrelated variables to consider, the number of shares offered and the offering price for the shares. It is generally felt that a minimum of 200,000 to 250,000 shares, and preferably 300,000 shares or even slightly more, is desirable in the public "float" to constitute a broad national distribution and to support an active trading market thereafter. As to price level, many of the larger investment banking firms and many investors are not particularly interested in dealing with securities offered at less than $10. The $5 level is often another psychological break point below which many investment bankers and investors lose interest. Any offering with an initial offering price of $20 or more is likely to import a prestige image.

For an offering of $3,000,000, 300,000 shares at $10 per share would be considered in the optimum range. If the offering is below $2,000,000 a decrease in the offering price per share is recommended, rather than a reduction in the number of shares offered below 200,000. These are matters of judgment, however, which should be reviewed carefully with the underwriters in each specific fact situation. In determining the amount of public investment which can be profitably employed in the business, the underwriters will normally evaluate the company's needs for funds and the dilution in earnings per share to result from the issuance of additional stock. If the optimum

level of proceeds to the company would constitute too small an offering, it may be desirable for existing shareholders to sell some of their own shares as part of the offering in order to increase its size. Sometimes the underwriters will suggest, or even insist, on a partial secondary offering with some shares to be sold by existing shareholders even though the shareholders would prefer to retain all of their shares.

The Registration Statement

The registration statement is the disclosure document required to be filed with the SEC in connection with a registered offering. It consists physically of two principal parts. Part I of the registration statement is the prospectus, which is the only part that normally goes to the public offerees of the securities. It is the legal offering document. Part II of the registration statement contains supplemental information which is available for public inspection at the office of the SEC.

The registration "forms" contain a series of detailed "items" and instructions, in response to which disclosures must be made. But, they are not forms in the sense that they have blanks to be completed like a tax return. Traditionally, the prospectus describes the company's business and responds to all the disclosures required in narrative rather than item-and-answer form. It is prepared as a brochure describing the company and the securities to be offered. The usual prospectus is a fairly stylized document and there is a customary sequence for organizing the material.

In the typical first public offering, the items which are most difficult to respond to, and which require the most creative effort in preparation, deal with the description of the company's business, its properties, material trans-

actions between the company and the insiders and how the proceeds will be used. Other matters required to be disclosed in the prospectus deal with the details of the underwriting, the plan for distributing the securities, capitalization, pending legal proceedings, description of securities being registered, identification of directors and officers and their remuneration, options to purchase securities and principal holders of securities. There are also detailed requirements concerning financial statements and financial information concerning the company's product lines.

In Part II of the registration statement there is supplemental information of a more formal type which is not required to be given to each investor. Unlike the prospectus, Part II is prepared in item-and-answer form. One requirement which is sometimes troublesome calls for disclosure of recent sales of unregistered securities and a statement of the exemption relied upon. Counsel may discover that past issuances of securities violated the '33 Act. In some such cases, the result is that the company's financial statements must reflect a very large contingent liability under the '33 Act. If past violations have been too flagrant, the offering may have to be deferred. Part II also contains supplemental financial schedules, as well as a list of exhibits which are filed with the registration statement. Normally, the information in Part II is not seen by individual investors, although sophisticated analysts and financial services may make extensive use of it.

The SEC, which reviews the registration statement, has no authority to pass on the merits of a particular offering. The SEC has no general power to prohibit an offering because it considers the investment opportunity to be a poor risk. The sole thrust of the Federal statute is dis-

closure of relevant information. No matter how speculative the investment, no matter how poor the risk, the offering will comply with Federal law *if* all the required facts are disclosed. By contrast, many state securities or "blue sky" laws, which are applicable in the jurisdictions where the distribution takes place, do regulate the merits of the securities.

In preparing a prospectus, the applicable form is merely the beginning. The forms are quite general and apply to all types of businesses, securities and offerings except for a few industries or limited situations for which special forms have been prepared. In the course of administration over the years, the Commission has given specific content to the general disclosure requirements. It often requires disclosures on a number of points within the scope of the form, but not explicitly covered by the form itself. Furthermore, in addition to information that the form expressly requires, the company must add any information necessary to make the statements made not misleading.[3] Thus, the prospectus may not contain a half-truth — a statement which is literally true but misleading in context.

The Commission's views on many matters change from time to time. SEC practitioners, both legal and accounting, constantly exchange news of what the Commission is currently requiring as reflected in its letters of comments. The SEC has also promulgated a set of official "guides" relating to the preparation and filing of registration statements.[4] These, as well as the applicable registration form, should be reviewed in detail as each new filing is prepared.

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3. SEC Rule 408, 17 C.F.R. § 230.408 (1969).

4. SEC Securities Act Release No. 4936 (Dec. 9, 1968).

The Commission has also evolved certain principles of emphasis in highlighting disclosures of adverse facts. As stated, it cannot prohibit an offering from being made, but it can make the offering look highly unattractive. In particular, if there are sufficient adverse factors in an offering, these are required to be set forth in detail in the very beginning of the prospectus under a caption such as "Introductory Statement" or "Risk Factors of the Offering."[5] However, many new issues of going businesses do not require this treatment and counsel must make a judgment in each case. Some of the adverse factors which may be collected under such a heading include: lack of business history, adverse business experience, operating losses, dependence upon particular customers, suppliers and key personnel, lack of a market for the security offered, competitive factors, certain types of transactions with insiders, a low book value for the stock compared to the offering price, potential dilution which may result from the exercise of convertible securities, options or warrants, and a small investment by the promoters compared with the public investment.

To the same end, the SEC has required that boldface reference be made to certain adverse factors on the prospectus cover page. The cover page statements must cross reference disclosures within the prospectus on such matters as high risk factors, immediate equity dilution of the public's investment and various forms of underwriting compensation beyond the normal spread. To add to the brew, the Commission sometimes insists that certain factors be emphasized beyond what the attorneys working on the matter consider to be their true importance. A usual example is that prominent attention must be called to transactions between the company and

5. *Id.*

its management. Often matters of relative insignificance, in terms of amounts involved, are made to appear very important by the amount of space given and placement in the prospectus.

The prospectus is a somewhat schizophrenic document, having two purposes which often present conflicting pulls. On the one hand, it is a selling document. It is used by the principal underwriters to form the underwriting syndicate and a dealer group, and by the underwriters and dealers to sell the securities to the public. From this point of view, it is desirable to present the best possible image. On the other hand, the prospectus is a disclosure document, an insurance policy against liability. With the view toward protection against liability, there is a tendency to resolve all doubts against the company and to make things look as bleak as possible. In balancing the purposes, established underwriters and experienced counsel, guided at least in part by their knowledge of the SEC staff attitudes, traditionally lean to a very conservative presentation. They avoid glowing adjectives, subjective evaluations and predictions about the future. The prospectus is limited to provable statements of historic fact. The layman frequently complains that all the glamor and romance has been lost. "Why can't you tell them," he says, "that we have the most aggressive and imaginative management in the industry?" It takes considerable client education before an attorney can answer this question to his client's satisfaction.

The quarterback in preparing the registration statement is normally the attorney for the company. He is principally responsible for preparing the non-financial parts of the registration statement. Drafts are circulated to all concerned. There are normally several major revisions before sending the job to the printer, and at least

a few more printed drafts before the final filing. Close cooperation is required among counsel for the company, the underwriters' counsel, the accountants and the printer. Unless each knows exactly what is expected of him by each of the others, additional delay, expense and irritation are inevitable.

Review by the SEC

After the registration statement is filed initially, the Commission reviews it to see that it appropriately responds to the applicable form and almost always finds some deficiencies which are communicated by its staff through the "deficiency letter" or "letter of comments." Amendments to the registration statement are then filed to meet the comments. When the deficiencies are cured, the SEC issues an order allowing the registration statement to become, to use the word of art, "effective." Only after the registration statement is effective may sales to the public take place.

If counsel, or the accountants, with respect to financial comments, feels that the staff's comments are inapposite or should not be met for some other reason, he will discuss them with the staff, usually by telephone but in person if the matter is sufficiently serious. The Commission's staff is generally reasonable in dealing with counsel's objections. However, as a practical matter, an offering cannot usually come to market unless an accommodation has been reached on all comments. Therefore, the staff usually has the last word on when the company has adequately met the comments, even if they are not legally binding in the formal sense.

Pre-effective Offers

In the interval between the first filing with the Commission and the effective date, the so-called "waiting period," the company and the underwriters may distribute preliminary or "red herring" prospectuses. The term "red herring" derives from the legend required to be printed in red ink on the cover of any prospectus which is distributed before the effective date of the registration statement. The legend is to the effect that a registration statement has been filed but has not become effective, and the securities may not be sold nor may offers to buy be accepted prior to the effective date.

During the waiting period oral selling efforts are permitted but no written sales literature — that is, "free writing" — is permitted other than the red herring prospectus.[6] Tombstone advertisements, so-called because the very limited notice of the offering which is permitted is often presented in a form resembling a tombstone, are not considered selling literature and may be published during the waiting period, although it is much more common for them to be published after the effective date.[7] Through the use of a red herring prospectus or by making oral offers by telephone or otherwise, the underwriters may offer the security and may accept "indications of interest" from purchasers prior to the effective date. However, as indicated, no sales can be made during the waiting period.

---

6. For SEC interpretations on permissible activities during the waiting period, as well as in the pre-filing and post-effective periods, see SEC Securities Act Release No. 5009 (Oct. 7, 1969); SEC Securities Act Release No. 4697 (May 28, 1964); SEC Securities Act Release No. 3844 (Oct. 8, 1957). Certain proposed new rules and rule changes relating to this subject generally are contained in SEC Securities Act Release No. 5010 (Oct. 7, 1969); Securities Exchange Act Release No. 8710 (Oct. 7, 1969).

7. SEC Rule 134, 17 C.F.R. § 230.134 (1969), regulates tombstone advertisements.

Ideally, the investor should have the final prospectus available on which to base his decision whether to buy the security. Often this is not the case. It is theoretically possible to avoid entirely the requirements for delivering a prospectus to a purchaser without violating the law. The requirements can be avoided if the completed transaction is consummated without using the mails or any means or instruments of interstate commerce for any step from initial offer to final payment by the purchaser. In the much more typical situation, the offer and acceptance is by telephone, and the buyer first receives the final prospectus in the mail with the confirmation of the sale. He is thereby informed, assuming that he reads the prospectus and can understand it, about what he has already purchased. However, the document arrives much too late to aid in his initial decision whether to buy the security. Indeed, one commentator has dubbed it a "retrospectus." In order to counteract this, the SEC has undertaken certain steps to insure that a final prospectus or a substantially final red herring will be sent in advance of the confirmation to those indicating an interest during the waiting period.[8]

The Underwriting Agreement

The company often signs a "letter of intent" with its managing underwriter once the selection of the underwriter has been made. If used, the letter outlines the proposed terms of the offering and the underwriting compensation. However, it expressly states that it is not intended to bind either party, with the possible exception of a binding provision dealing with payment of expenses if one party abandons the transaction.

---

8. SEC Securities Act Release No. 5010 (Oct. 7, 1969); SEC Securities Act Release No. 4968 (Apr. 24, 1969).

In a "firm commitment" underwriting agreement, the underwriters agree that they will purchase the shares being offered for the purpose of resale to the public. The underwriters must pay for and hold the shares for their own account if they are not successful in finding public purchasers. This form of underwriting is almost always used by the larger underwriters, and provides the greater assurance of raising the desired funds. In the other common type of underwriting arrangement, the underwriters agree to use their "best efforts" to sell the issue as the company's agent. To the extent that purchasers cannot be found, the issue is not sold. Some best efforts agreements provide that no shares will be sold unless buyers can be found for all, while others set a lower minimum such as 50 percent.

In either form of underwriting, the underwriters' obligations are usually subject to many conditions, various "outs" (*e.g.*, the right not to close in the event of certain specified adverse developments prior to the closing date) and compliance by the company with its numerous representations and warranties. The underwriters also condition their obligations upon the receipt of certain opinions of counsel and representations, sometimes called a "cold comfort letter," from the company's auditors.

The binding underwriting agreement is not normally signed until within 24 hours of the expected effective date of the registration statement — often on the morning of effectiveness. Thus, throughout the process of preparing the registration statement and during the waiting period, the company has incurred very substantial expenses with no assurance that the offering will take place. Once preparation of the registration statement has begun, however, reputable underwriters rarely refuse to complete the offering, although this can occur with some frequency,

especially for small and highly speculative offerings, if there is a sharp market drop during the waiting period. However, as indicated above, the underwriters must price the offering and organize the underwriting syndicate in relationship to market conditions prevailing at the time of the offering. Thus, if market conditions have worsened materially after the letter of intent stage, the issue must either come to the market at a price below that originally contemplated, or it must be postponed until conditions improve. On the other hand, sharply improved market conditions may result in a higher offering price than the parties originally anticipated.

Final settlement with the underwriters usually takes place seven to ten days after the registration statement has become effective, so as to allow the underwriters time to obtain the funds from their customers. At that time, the company receives the proceeds of the sale, net of the underwriting compensation.

Appendix C

[Excerpts from
GUIDES FOR PREPARATION AND FILING
OF
REGISTRATION STATEMENTS,
Securities Act of 1933 Release No. 4936, as amended.]

GENERAL PROVISIONS

1. Pre-filing Conferences with Registrants.

The Commission has a long established policy of holding its staff available for conferences with prospective registrants or their representatives in advance of filing a registration statement. These conferences may be held for the purpose of discussing generally the problems confronting a registrant in effecting registration or to resolve specific problems of an unusual nature which are sometimes presented by involved or complicated financial transactions.

Occasionally a registrant will request a pre-filing review of a registration statement, but such a review has been refused since it would delay the examination of material which has already been filed and would favor certain issuers at the expense of others. Registrants or their representatives also occasionally request the staff to draft a paragraph or other statement which will comply with some requirement or request for disclosure. The staff cannot undertake to prepare material for filing but limits itself to stating the kind of disclosures required, leaving the actual drafting to the registrant and its representatives.

2. Letter of Comment.

Letters of comment are sent out in most cases as a means of informing registrants of the respects in which a

registration statement is deemed not to meet the disclosure and other requirements of the Act and the forms and regulations thereunder. A letter of comment may not be sent out, however, where the circumstances are such that an investigatory or stop order proceeding is deemed more appropriate.

. . . .

5. Preparation of Prospectuses.

In order to make prospectuses more readable and understandable, and therefore more useful, registrants should limit their length and complexity by careful organization of the material, appropriate arrangement and subordination of information, use of tables and the avoidance of prolix or technical language and unnecessary detail. In this connection, attention is directed to Rule 460(f).

Material on the cover page should be as brief as possible with an appropriate cross reference to more complete information elsewhere in the prospectus which also should be used in lieu of explanatory notes on the cover page. Generally the cover page should be presented in accordance with the following guidelines except where special circumstances warrant additional disclosure.

a. Name of the issuer;

b. Description and amount of securities offered including, for example, appropriate disclosure of redemption and conversion features of debt securities;

c. The statement required by Rule 425;

d. The table showing the per unit and total offering price to the public, underwriting discounts and commissions and proceeds to the registrant or other persons;

Note: A separate section should be included in the body of the prospectus explaining the details of the compensation and any other benefits accruing to the underwriters including the aggregate cash payments made to the underwriters in connection with the offering such as expenses, finders' fees and investment counseling fees. All that is required on the cover page is a cross-reference to this section for an explanation of the underwriters compensation. Where an underwriter has received an over-allotment option, maximum-minimum information should be presented in the price table based on the purchase of all or none of the shares subject to the option. The terms of the option should be described in connection with the other compensation to underwriters rather than on the cover page.

e. The name of the underwriter or underwriters;

f. The date of the prospectus;

g. If applicable, a brief identification of the material risks involved in the purchase of the securities with a cross-reference to further discussion in the body of the prospectus; and

Note: If there has been no previous market for the company's securities, this should be stated in connection with the identification of risks. While no explanation need be given on the cover page as to the method of determining the offering price, there should be appropriate cross reference to further discussion in the prospectus.

h. Any material required by the laws of any state in which the securities are to be offered.

Note to Guide 5: Where an offering is not underwritten, or is underwritten on a best efforts basis or where

there is an exchange offer or rights offering the disclosures should be modified accordingly but every effort should be made to retain the brevity of the disclosure.

Stock phrases such as "There can be no assurance that the registrant will succeed in developing a commercial market for its product" or "A substantial number of companies that are engaged in the same business as the registrant have greater financial resources, experience and are better known to the public than registrant" or "In the opinion of management the unfavorable determination of any pending litigation would have no material effect on the business or financial condition of the company", *may not* provide meaningful disclosure unless accompanied by a brief explanation of the basis for such statements or the effect such conditions may have on the business of the registrant.

. . . .

6. Introductory Statements.

Where appropriate to a clear understanding by investors, there should be set forth immediately following the cover page of the prospectus under an appropriate caption a carefully organized series of short, concise paragraphs, under subcaptions where appropriate, summarizing the principal factors which make the offering one of high risk or speculative. These factors may be due to such matters as an absence of an operating history of the registrant, an absence of profitable operations in recent periods, the financial condition of the registrant, or the nature of the business in which the registrant is engaged or proposes to engage. In this connection, see In the Matter of Universal Camera Corporation, 19 S.E.C.

648 (1945) and In the Matter of Doman Helicopter, Inc., 41 S.E.C. 431 (1963).

Appendix D

[Excerpts from Wheat* & Blackstone,* GUIDEPOSTS FOR A FIRST PUBLIC OFFERING, 15 BUSINESS LAWYER 539, 560-62 (1960).]

As a by-product of the ever increasing tide of public securities issues, more and more lawyers face the tedious and complex task of preparing a registration statement under the Federal Securities Act. Not the least of the lawyer's problems may be encountered in advising an inexperienced client as to why this mysterious process takes so long, why valuable company officers should be required to spend so much time answering apparently endless questions, and what the total cost is likely to be. Not infrequently, the company lawyer is expected to furnish aid and comfort to his client in negotiations with a firm of investment bankers whose expertise and accumulated experience he cannot hope to match.

The purpose of this article is to touch upon a few points of practice in this somewhat specialized field of finance which lie almost wholly outside the law and the case books — although they are by no means new to the pages of *The Business Lawyer*.[1]

The discussion will center about a young and prosperous company named Plastic Products Co.[2] (later changed

*Members of the California Bar. [Mr. Wheat was a member of the Securities and Exchange Commission from 1964 through 1969.]

1. See, *e.g.*, Weisbrod, *Regulatory Aspects of Financing*, 14 Bus. Law. 910 (July, 1959); Glavin and Purcell, *Securities Offerings and Regulation A – Requirements and Risks*, 13 Bus. Law. 303 (April, 1958).

2. The names used herein are fictional and any resemblance to actual persons, firms or corporations of the same or similar names is purely coincidental.

to "Plastron, Inc." for reasons which will appear) which explores the possibility of a public stock offering, negotiates with an investment banking firm and ultimately proceeds with the preparation and filing of a registration statement.

. . . .

At the very outset of the proceedings, the company's officers should be warned not to issue publicity releases on the company and not to make statements for publication concerning the company's future plans and prospects without advance consultation with counsel. Any unusual publicity in advance of a proposed offering may be regarded by the SEC as an effort to condition the market for the company's securities by an illegal means (i.e., by means other than the statutory prospectus) and may result in an SEC-imposed delay in the offering.

* * *

After receiving the various items of information and documents produced for him by company officials, Mr. Jones has prepared a rough draft of the prospectus. With a certain pride of authorship, he gives a copy to Mr. Fisher who, after glancing through it, almost explodes:

"There's No Life In This Thing, Mr. Jones. How Can We Sell Stock With A Prospectus Like This?"

Mr. Fisher's question has been asked a thousand times before. It is up to Mr. Jones to explain that a prospectus is not intended to "sell" the company's stock in the same terms that Madison Avenue uses to sell the company's products. Instead, its prime function is to inform the potential investor of the risks inherent in ownership of the business. The prospectus cannot be expected to mirror Mr. Fisher's shining faith in the company's future — a

projection of the company's earnings for the next five years would be out of the question. Similarly, it cannot reflect the confidence of management that a new product (still in the research stage) will revolutionize the industry. Generally speaking, statements in the prospectus which are designed to make the company look good or to overcome the effect of disclosures of unfavorable factors will cause the most agony when the deficiency letter is received from the SEC.

Mr. Fisher listens carefully as his lawyer outlines the civil liabilities which persons signing the registration statement may incur under Section 11 of the Securities Act in the event there should be a misstatement or omission of a material fact. He takes comfort in the fact that prospectuses published by competitors are likewise devoid of glamour. He is advised that the prospectus should be regarded as a form of insurance policy written with great care to protect Mr. Fisher, his fellow directors and the company against unexpected (and hitherto non-existent) liabilities.

With this explanation, Mr. Fisher finds it easier to accept the over-all "negative" approach of the prospectus. However, he still questions the necessity for certain disclosures contained in Mr. Jones' draft.

Emphasis on Risks to the Investor: Mr. Jones has decided that it is not necessary for the cover page of the prospectus to carry a legend labeling the offering as a "speculation," which is often done for an unseasoned company. However, he is of the opinion that there are sufficient risks to the investor in Plastron, Inc. that they should be clearly identified at the outset (although Form S-1 does not specifically so require). In an "Introductory Statement" he has called attention to the organization of the company within the last five years, the recent loss of

a major customer for an important product, the acquisition by selling stockholders of their shares at nominal cost, and the immediate dilution to the new investor of his investment from a book value point of view. The volunteering of such an "Introductory Statement" will perhaps avoid an elaborate "deficiency" suggestion from the SEC staff as to introductory disclosures they deem necessary in order for the prospectus as a whole not to be misleading. Mr. Jones is aware of the staff's view that various unfavorable facts should not be scattered through the prospectus. If, in the context of the industry, the company presents unusual risks to the investor, a disclosure of such risks in the forepart of the prospectus is in order.

Discussion of Unfavorable Business Trends and Competition: Information appears in the section entitled "History and Business" showing that the backlog of orders as of December 31, 1959, was smaller than the backlog as of December 31, 1958. In addition, it is disclosed that the backlog of defense orders is proportionately larger than it was the previous year. It is stated that the profit margin on its defense business is higher than on commercial business, that profits from defense business are subject to renegotiation, and that defense contracts are subject to cancellation at the convenience of the government. Mr. Fisher reluctantly concedes that such facts have a material bearing on the profit potential of the company and should therefore be disclosed to investors.

Under the caption "Competition" there is a statement that the company's major competitors have much greater financial and other resources for research and development than has the company. To counter this, Mr. Fisher wants to describe his company as the "leader" in the field of plastic hardware, but in the absence of reliable sta-

tistics as to comparative dollar sales of competitors in this field, Mr. Jones does not believe it wise to engage in such self-congratulation.

Disclosures Concerning Management: No officer or director other than Mr. Fisher received compensation in excess of $30,000 in 1959, but it must be disclosed that Mr. Fisher's salary and bonuses for 1959 totaled $42,500 and that an aggregate remuneration of $112,800 was paid during 1959 to all directors and officers as a group. The terms of Mr. Fisher's five year employment contract expiring in 1964 must also be revealed, much to Mr. Fisher's annoyance.

Disclosure is made as to restricted stock options granted to Mr. Fisher, his associates and three other key employees in September, 1959, at option prices substantially below the offering price to the public.

It is stated that Mr. Fisher and his two associates took the initiative in organizing the company and that Mr. Fisher received half of his stock for promotional services, the balance of the shares issued to the organizers having been purchased by them for 10 cents a share (adjusted for the 100 for 1 stock split). (Such information is required by instructions to Item 11 of Form S-1 in view of the organization of the company within five years.) Information is also given concerning the terms of the lease by the company from Mr. Fisher of its principal factory building, including the annual rental and the original cost of the property to the lessor.

• • •

It comes almost as a surprise to Mr. Fisher that the registration statement is effective on schedule. At the closing conference on Monday morning one week later the company and the selling stockholders receive their

checks and Mr. Fisher suggests to his associates that they join him for a cup of coffee before going back to the plant. Mr. Jones' response is purely instinctive: "Did he say *coffee*? . . ."

No. 74-124

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October Term, 1974

Supreme Court, U. S.
FILED
FEB 1 1975
MICHAEL RODAK, JR., CLERK

Blue Chip Stamps, et al.,

Petitioners,

v.

Manor Drug Stores, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

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TOPICAL INDEX

	Page
Table of Authorities	iii
OPINIONS BELOW	1
JURISDICTION	2
QUESTIONS PRESENTED	3
STATUTORY PROVISIONS INVOLVED	5
STATEMENT OF THE CASE	7
STATEMENT OF FACTS	10
SUMMARY OF ARGUMENT	16a
ARGUMENT	17
I GRANTING STANDING TO SUE UNDER §10(b) TO A PERSON WHO HAS AN ENTITLEMENT EQUIVALENT TO THAT OF A CONTRACT RIGHT TO PURCHASE SECURITIES COMPORTS WITH THE PURPOSES AND POLICIES OF THE SECURITIES EXCHANGE ACT OF 1934 AND THE SECURITIES ACT OF 1933	17
II RESPONDENT HAS NOT CONTENDED NOR DOES THE COURT OF APPEALS OPINION HOLD THAT STANDING HEREIN HAS ANY RELEVANT CONNECTION WITH ENFORCEMENT OF A CONSENT DECREE BY A THIRD PARTY	60
CONCLUSION	62

Page

APPENDIX A

15 U.S.C. §78bb

APPENDIX B

Plaintiff-Appellant's
Supplemental Brief

TABLE OF AUTHORITIES

Cases	Page
Affiliated Ute Citizens v. United States, 406 U.S. 128	35, 51
A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2nd Cir. 1967)	25, 26
Birnbaum v. Newport Steel Co., 193 F.2d 461 (2nd Cir. 1952), cert. denied, 343 U.S. 456 (1952)	9, 21, 23, 24, 26, 28-32, 34, 53, 57
Coffee v. Permian Corp., 434 F.2d 383 (5th Cir. 1970)	24
Commerce Reporting Co. v. Puretec, Inc., 290 F. Supp. 715 (S.D. N.Y. 1965)	25-27, 36, 59
Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir. 1967)	24
Eason v. General Motors Acceptance Corporation, 490 F.2d 654 (7th 1973)	31, 32, 34, 51, 53, 54
Flast v. Cohen, 392 U.S. at 94	57

Cases	Page
Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N.D. Ill. 1967)	25, 26, 36
Herpich v. Wallace, 430 F.2d 792 (5th Cir. 1970)	37
Hooper v. Mountain States Securities Corp., 282 F.2d 195 (5th Cir. 1960), cert. denied, 365 U.S. 814 (1961)	25
Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa.)	18, 19
Mader v. Armel, 402 F.2d 158 (6th Cir. 1968), cert. denied, 394 U.S. 940 (1969)	24
Mutual Shores Corp. v. Genesco, Inc., 384 F.2d 540 (1967)	26
Neuman v. Electronic Specialty Co., (1969-1970 Transfer Binder) C.C.H. Fed. Sec. L. Rep. para. 92, 591 (N.D. Ill. 1969)	26
Ruckle v. Roto American Corp., 339 F.2d 24 (2nd Cir. 1964)	25

Cases	Page
Schoenbaum v. Firstbrook, 405 F.2d 215 (2nd Cir. 1968), cert. denied, 395 U.S. 906 (1969)	25
SEC v. Capital Gains Research Bureau, 375 U.S. 180	35
SEC v. National Securities, Inc., 393 U.S. 453	38
Site v. Leasco Data Processing Equipment Corp., 332 F. Supp. 544 (E.D. N.Y. 1971)	59
Stockwell v. Reynolds & Co., 252 F. Supp. 215 (S.D. N.Y. 1956)	26, 27, 36
Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555 (1931)	59
Superintendent of Insurance v. Bankers Life and Casualty Co., 404 U.S. 6 (1971)	19, 23, 35, 51, 54, 55
United States v. Armour & Co., 402 U.S. 673 (1971)	61

Cases	Page
Vine v. Beneficial Finance Company, 374 F.2d 627, cert. denied, 389 U.S. 970 (1970)	24

Statutes

Securities Act of 1933:	
§5(c)	29
§12	10, 17, 29, 52, 55
Securities Exchange Act of 1934:	
§9(a)(2)	29
§9(a)(3)	29
§9(a)(4)	29
§10(b)	3-5, 17-24, 26, 28, 32, 34, 37, 38, 52, 53, 55, 58
§14(e)	29
§15(c)(1)	29
§15(c)(3)	29
§16(b)	30
§18(a)	30
15 U.S.C. §78bb	7, 58
15 U.S.C. 78j(b)	3, 5, 10

Statutes	Page
Sherman Anti-Trust Act	10
28 U.S.C. §1254(1)	3
Regulations	
17 C.F.R. §240.10b-5	6, 10
Rules	
Securities and Exchange Commission	
Rule 10b-5	3, 4, 6, 9, 10, 17-20, 28, 32, 37, 53
Texts	
Comment, The Decline of the Purchaser-Seller Requirement of Rule 10b-5, 14 Vill. L. Rev. 499, 501-502 (1969)	30
Comment, The Purchaser-Seller Rule: An Archaic Tool for Determining Standing under Rule 10b-5, 56 Geo. L.J. 1177, 1178 (1968)	30
Lowenfels, The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5, 54 Va. L. Rev. 268, 275-276 (1968)	30
Note, the Purchaser-Seller Limitation to SEC Rule 10b-5, 53 Cornell L. Rev. 684, 698 (1968)	30

Texts	Page
Ruder, Current Developments In the Federal Law of Corporate Fiduciary Relations -- Standing to Sue Under Rule 10b-5, 26 Bus. Law, 1289 (1971)	30

Miscellaneous

H.R. Rep. No. 85, 73d Cong., 1st Sess. 8 (1933)	56
H.R. Rep. No. 1383, 73d Cong., 2d Sess. 2 (1934)	18
S. Rep. No. 1455, 73d Cong., 2d Sess. 81 (1934_	18

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The majority and dissenting opinions of the Court of Appeals for the Ninth Circuit are set

forth in the separate Appendix at App. 133 through 153 and modifications by the panel thereto are found at App. 154 through 156. The modified opinions are reported in 492 F. 2d 136. The opinion and order of the district court are set forth at App. 123 through 131 and are reported at 339 F. Supp. 35.

JURISDICTION

On October 15, 1973, a panel of the court of appeals entered its decision reversing the district court's dismissal of the amended complaint. The matter was ordered remanded for further proceedings. (App. at 142.) On October 26, 1973, a justice of the court of appeals extended the time for petitioning for a rehearing in banc and ordered the mandate stayed. Timely petitions for a rehearing in banc were then filed. On April 1, 1974, an order was entered denying the petitions and making minor changes in the panel's

opinions. Five active circuit judges noted that they would have granted a rehearing in banc. (App. at 154-56.) On June 21, 1974, Mr. Justice Douglas extended the time for filing a petition for certiorari to and including August 15, 1974. The petition was filed on August 15, 1974, and the writ granted on November 11, 1974. On December 23, 1974 petitioners requested an extension of time within which to file their opening brief herein and on December 26, 1974 the Court extended the time to and including December 31, 1974. Respondent received petitioner's brief on January 2, 1975. The Court's jurisdiction has been invoked pursuant to 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Do Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5

of the Securities and Exchange Commission deny standing in a civil damage action to a plaintiff who has a right or entitlement to purchase securities but is deprived of exercising said right or entitlement because of the fraud of the offeror?

2. Does permitting standing to sue under section 10(b) of the Securities Exchange Act of 1934 to persons who had a right or entitlement to purchase offered securities and who would have so purchased but for the alleged fraud of the petitioners irreconcilably conflict with the disclosure purposes of the Securities Act of 1933?

(Petitioners have presented to the Court the following question which respondent does not concede is a viable or dispositive issue in this action.)

3. Can a person who is not a party to a federal antitrust consent decree assert in a separate action rights alleged to derive from that decree?

STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), provides in pertinent part:

"§ 78j. Manipulative and deceptive devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, of any facility of any national securities exchange--

" . . .

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated by the Securities and Exchange Commission, provides as follows:

"§240.10b-5 Employment of manipulative and deceptive devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Section 28 of the Securities Exchange Act of 1934, 15 U.S.C. §78bb, is set forth in pertinent part as Appendix "A" to this brief at Br. App. 1.

STATEMENT OF THE CASE

Respondent, Manor Drug Stores and others similarly situated comprise a specific class of persons[1] who were entitled to but were dissuaded from purchasing securities of Blue Chip Stamps as a result of the alleged fraudulent activities of petitioner Blue Chip Stamps, Blue Chip

---

1 This class of persons has been denominated throughout these proceedings and in the antecedent antitrust action as "Users", a term used to describe retail issuers of Blue Chip Stamp Company who issue such stamps to their customers as a reward for their patronage. (App. at 9.)

Stamp Company and named directors and major shareholders of Blue Chip Stamps.[2]

Respondent filed this action for damages in federal district court on November 10, 1970,[3] and on March 5, 1971, petitioners moved for dismissal of the action, which motion was granted on May 25, 1971, by J. Kelleher (App. at 123 through 131). The basis for the district court's dismissal was the speculativeness of plainitiff's damages and the alleged continuing validity and

---

2 Specifically, the named defendants-petitioners in this litigation are: Blue Chip Stamps, a corporation, Blue Chip Stamp Company, a merged corporation, Lucky Stores, Inc., Market Basket, a corporation, Purity Stores, Inc., Ralphs Grocery Company, a corporation, Safeway Stores, Inc., Thriftimart, Inc., Vons Grocery Co., a corporation, Robert E. Alexander, Donald A. Koeppell, Leonard Straus, William F. Ramsey, Robert E. Laverity, Richard Ralphs, John R. Niven, Fred Von Der Ahe.

3 Prior to service of the original complaint, respondent filed and served an amended complaint, which constitutes the sole pleading before the Court and which is set forth with Exhibits thereto at App. 4 through 122.

sound policy of the purchase or sale limitations established in Birnbaum v. Newport Steel Corp., 193 F. 2d (2d Cir. 1952), cert. denied, 343 U.S. 456 (1952).

Respondent appealed to the United States Court of Appeals for the Ninth Circuit and, on October 15, 1973, that court in a 2-1 decision issued its Opinion (App. at 133 through 153) reversing the lower court's dismissal and remanding the case for further proceedings. The basis of the court of appeals decision was that the consent decree involved herein served the same function as did the contractual relationship found in other cases wherein standing was found to exist under Section 10(b) and Rule 10b-5 despite the Birnbaum restriction (App. at 141 and 155).

Petitioners thereupon applied for a rehearing in banc, which was denied on April 1, 1974 (App. at 154 through 156).

STATEMENT OF FACTS

This is an action which is based upon a unique set of facts and which seeks damages under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10(b)-5. [4]

The facts as alleged in the amended complaint and which in light of the trial court's dismissal, are deemed to be true, show the following:

As a result of various alleged violations of the Sherman Anti-Trust Act, the United States government filed a civil action in 1963 against Blue Chip Stamp Company and all of the corporate shareholder defendants named herein. (App.

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[4] The amended complaint also sought damages for violations of §12 of the Securities Act of 1933, but the viability of the causes of action based upon said Act have not been urged during the appellate process and are not, therefore, before this Court.

at 8, 23.) Permitted appearance in said action was the Attorney General of the State of California on behalf of users other than those who were shareholders of Blue Chip Stamp Company and various trade associations, including the California Grocers Association and Certified Grocers of California, Ltd., each of whom included within their constituency a proportion of users herein. (App. at 10.)

All of said Users' representatives contended before the trial court that they, in fact, owned an interest in the defendant, Blue Chip Stamp Company and the Twenty Million Dollars in profits it had accumulated during the five years immediately prior thereto, and that in any decision of said government case, the ownership of said users of an interest in the said defendant, Blue Chip Stamp Company, should be decreed. (App. at 10.)

On June 5, 1967, a Consent Decree (App. at 23 through 35) was entered in the anti-trust

action, which decree called for a plan of reorganization to be submitted to and approved by the court. (App. at 27.) The third attempt at a satisfactory plan of reorganization (App. at 40 through 54) was subsequently lodged with and approved by the court and made a part of the Consent Decree (App. at 8).

The approved plan of reorganization required among other things the formation of a "new company", which was later entitled Blue Chip Stamps, and the divestment of the ownership interest of the shareholder defendants herein. (App. 9.) Also, and most significantly, said approved plan called for an offering of approximately 621,600 shares of the common stock of Blue Chip Stamps to "users" of Blue Chip Stamps on a pro rata basis to be determined by the quantity of stamp pads issued to "users" during a designated prior period. The offering was to be made in "units" consisting of three shares of the newly formed company and one $100.00 debenture for a cash consideration

of $101. (App. at 9.)

It is alleged that the foregoing described offering to the users was a bargain, intended by both the court and the parties, in that the reasonable market value of said units at the time of the offering was at least $315.00, or a net bargain to the users of $214.00 per unit. (App. at 11.) It is further alleged in the amended complaint that the said offering to the users versus the investing public at large and the bargain price were prompted by the claims and contentions by and on behalf of the users and their representatives during the antitrust proceedings and, particularly, in arguments before the court in hearings regarding the proposed plans for reorganization. (App. at 10.) [5]

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5 These claims and contentions and the recognition of their validity by petitioners' own counsel in the antitrust action are set forth in Appendix "B" of this brief and digested and discussed, infra, in the Argument portion of this brief.

Pursuant to the approved plan of reorganization and Consent Decree, Blue Chip Stamps was formed in about July, 1968, and issued 621,600 shares of stock to the stockholders of Blue Chip Stamps Company (of which approximately 560,000 shares went to the defendants herein); 27,600 shares were reserved for offering to certain of its employees; 10,400 shares were reserved for issuance pursuant to its qualified Stock Option Plan; and an additional 621,600 shares were earmarked for offering to the users of Blue Chip Stamps, including respondent herein.

As part of the offering to the users, petitioners caused to be published and delivered to said users a prospectus dated August 29, 1968 (App. at 55 through 90), which prospectus constituted a deceptive and manipulative device in that it contrived negative aspects to the offering and over-emphasized or fabricated adverse contingencies. Specifically, said "negative prospectus" unjustifiably warned the offeree-users that:

(1) the net income from the current fiscal year would be adversely affected by payment of $7,928,000.00 in settlement of claims against Blue Chip Stamps; (2) net income would be adversely affected by a substantial decrease in the use of trading stamps; (3) net income would be adversely affected by a sale of one-third of the company's trading stamp business in California; (4) claims or causes of action against the company aggregated approximately $29,000,000.00; and, (5) all but two of the present directors were precluded from continuing to serve on the company's board of directors until June 5, 1977. (App. at 13 through 15, 55 through 90.)

In truth and in fact, said representations were false or should have been known to be so in that, for instance, the $29,000,000.00 in purported claims and causes of action were settled by the defendants for less than $1,000,000.00 less than three months later and some of which were settled prior to the issuance of the "negative pros-

pectus". (App. at 15.)

The aforesaid negative aspects of Blue Chip Stamps securities were not included in a public offering and prospectus made one year later (App. at 91 through 122), despite the fact that to the extent they were relevant at the time of the offering to respondent herein they would have been relevant at the time of the offering to the general public. (App. at 15.)

These misrepresentations and instances of over-emphasis were not without design or purpose. The petitioners emphasized said "negative prospectus" in order to accomplish the desired effect of enhancing the value of their own stock holdings in Blue Chip Stamps and creating a premium price for future sales of Blue Chip Stamps securities on the public market. (App. at 13.)

The respondent herein represents the approximate forty percent (300,000 shares) of users who were entitled to but were dissuaded by the

above described "negative prospectus" from exercising their entitlement to purchase Blue Chip Stamps securities. Respondent seeks damages, which are mathematically computed at $21,400,000.00, or the right to purchase their prescribed amount of shares at the original offering price at the 1968 users' offering.

SUMMARY OF ARGUMENT

The facts in the instant case present a unique circumstance in Section 10(b) litigation in that the respondent, while technically not a purchaser or seller, owned a "right" to purchase the securities offered by petitioners. That "right" served as the functional equivalent of a contractual relationship, a basis upon which Courts have historically granted standing under §10(b). Because of this unique right and the facts peculiar to this case, the decision below has singular applicatcn to the case at bar and, as so distin-

guished, does not create a conflict with the Securities Act of 1933 or act as a harbinger of a flood of unmeritorious lawsuits under federal securities laws.

Also, the decision below does not overrule or joepardize previous rulings of this and other courts to the effect that a consent decree may not be enforced by a non-party thereto.

ARGUMENT

I.

GRANTING STANDING TO SUE UNDER §10(b) TO A PERSON WHO HAS AN ENTITLEMENT EQUIVALENT TO THAT OF A CONTRACT RIGHT TO PURCHASE SECURITIES COMPORTS WITH THE PURPOSES AND POLICIES OF THE SECURITIES EXCHANGE ACT OF 1934 AND THE SECURITIES ACT OF 1933.

A. The Purchaser-Seller requirement is a court created restriction and its application has

been significantly limited throughout the circuits.

The Securities Act of 1933 and the Securities Exchange Act of 1934 were enacted by Congress as a means of alleviating and punishing abuses which had occurred and continued to occur in the securities market and which had been the major contributing causes of the stockmarket crash of 1929.[6] Language expressly granting a private right of action for civil damages for violations of section 10(b) and Rule 10b-5 is not found in those provisions or otherwise in the Act itself. Since 1946 and the decision of Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa.), however, the courts have universally accepted the

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6 H. R. Rep. No. 1383, 73d, Cong., 2d Sess., 2 (1934); S. Rep. No. 1455, 73d Cong., 2d Sess., 81 (1934).

proposition that a private right of action under 10(b) and 10b-5 does exist. [7]

In first recognizing this right to civil remedies under 10(b) and 10b-5 the court in Kardon held:

> "Where, as here, the whole statute discloses a broad purpose to regulate securities transactions of all kinds and, as a part of such regulation, the specific section in question provides for the elimination of all manipulative or deceptive methods in such transactions, the construction contended for by the defendants may not be adopted. In other words, in view of the general purpose of the Act, the mere omission of an express provision for civil liability is not sufficient to negative

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[7] This Court has confirmed that a private right of action is implied under §10(b). Superintendent of Insurance v. Bankers Life and Casualty Co., 404 U.S. 6, 13, n. 9.

what the general law implies." 69 F. Supp. at 514.

Just as the Act and regulations are silent with respect to the availability of civil redress in private actions, so, too, are they mute regarding what has developed to be known as the purchaser-seller limitation. Section 10(b) is phrased in general, broadly encompassing language. Its relevant proscription states that it shall be unlawful for any person:

> "To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules or regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

The quoted statute does not limit standing to assert a violation of its provisions to a purchaser or seller; likewise, Rule 10b-5 makes no such restriction. The purchaser-seller require-

ment, as such there is, was created by a court of law in the case of Birnbaum v. Newport Steel Corp., 193 F. 2d 461 (2d Cir. 1952). While respondent submits that the Birnbaum case stands for no more than the singular proposition that 10(b) may not be used as a means of redress for corporate mismanagement where the complaining party held no interest in the questioned securities transaction, in light of the reliance placed upon that case by petitioners a discussion of its facts is called for.

In Birnbaum, the defendant corporation was negotiating with Follansbee Steel Corp., for a merger which would have been highly profitable to defendant's stockholders. Pursuant to a fraudulent scheme, Feldmann, president of the defendant corporation, called the merger off and sold his stock to another corporation, Willport Company, at double its then market value. This sale of stock gave Willport Company control over the defendant corporation. The alleged fraud concerned

certain misrepresentations contained in letters sent by the defendants to plaintiff stockholders which provided false information concerning the aborted merger and the Feldmann sale. The plaintiffs, defendant corporation stockholders, brought an action under §10(b) alleging that they had been damaged as a result of the Feldmann sale and the termination of the merger negotiations in that they had been deprived of an increase in the value of their stock.

The plaintiffs contended that the Feldmann sale satisfied the 'in connection with purchase or sale of a security' requirement of §10(b); however, at no time were the plaintiffs in any way parties to the transaction, but rather, were mere bystanders. What the plaintiffs were really seeking was a cause of action for a breach of fiduciary duty on the part of the directors of the defendant corporation. The Court realized this and held that fraud perpetrated upon a purchaser or seller of securities has no relation to breaches of fi-

duciary duty by corporate insiders resulting in fraud upon those who were not purchasers or sellers.

The plaintiffs in Birnbaum were not purchasers, sellers, offerors, or offerees, nor did they enjoy any type of unique status which would constitute a rational and causal nexus with the challenged securities transaction. Those plaintiffs were mere bystanders to the stock sale who attempted to employ 10(b) as a means of punishing management's breach of its fiduciary duties. Respondent has urged throughout these proceedings that Birnbaum, so limited, is a correct proposition of law.[8] Unfortunately, many cases

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8 Respondent believes this analysis of Birnbaum to be consistent with the expression of this Court in Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6, 13-14, n. 10, although the Court did not reach the Birnbaum issue.

subsequent to Birnbaum attributed to it a much broader scope and applied its holding as a standing requirement to all 10(b) actions.

Due to the unfairness which had developed as a result of the Birnbaum purchaser-seller limitation, courts began to search for and find alternatives to this "standing" requirement. Thus, acknowledged exceptions to the purchaser-seller requirement emerged. In the twenty-two years since Birnbaum was decided, therefore, we have seen the courts grant "standing" to plaintiffs who found themselves in the position of being "forced sellers"[9] where the only securities transaction had been a corporate merger[10] or

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9 Vine v. Beneficial Financial Company, 374 F. 2d 627, cert. denied, 389 U.S. 970; Dasho v. Susquehanna Corp., 380 F. 2d 262 (7th Cir. 1967); Mader v. Armel, 402 F. 2d 158 (6th Cir. 1968), cert. denied, 394 U.S. 940 (1969).

10 Coffee v. Permian Corp., 434 F. 2d 383 (5th Cir. 1970).

issuance by a corporation of its own shares [11]; to a plaintiff which was a stock brokerage firm and had ordered securites for which its customers later refused to pay [12]; to plaintiffs who were frustrated in their alleged attempt to purchase securities [13]; and to plaintiffs who had unwittingly purchased non-existent stock. [14]

In each of the above categories of exceptions none of the plaintiffs could be said to have been an actual or technical purchaser or seller. Yet, in each case the court found that the remedial

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11 Hooper v. Mountain States Securities Corp. 282 F.2d 195 (5th Cir. 1960), cert. denied, 365 U.S. 814 (1961); Ruckle v. Roto American Corp., 339 F.2d 24 (2d Cir. 1964); Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969).

12 A. T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967).

13 Commerce Reporting Co. v. Puretec, Inc., 290 F. Supp. 715 (S.D.N.Y. 1965).

14 Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N.D. Ill. 1967).

purposes of the Act intended that the type of fraud alleged was of the ilk intended to be outlawed by 10(b) and for which a private damage action should lie.

The Perlow, Puretec and Hentz cases cited below and the case of Stockwell v. Reynolds & Co., 252 F. Supp. 215 (S.D.N.Y. 1956) are representative of the class of exceptions to the Birnbaum rule which has come to be known as the aborted purchaser or seller, or causation, exception. [15] In Stockwell, for instance, the plaintiffs were fraudulently induced to retain their shares rather than sell them. The court in considering the Birnbaum case and still granting standing stated:

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15 See, also, Neuman v. Electronic Specialty Co., [1969-1970 Transfer Binder] C.C.H. Fed. Sec. L. Rep. para. 92, 591 (N.D. Ill. 1969)| The Second Circuit which decided Birnbaum has abandoned the purchaser-seller limitation in injunction cases. Mutual Shores Corp. v. Genesco, Inc., 384 F. 2d 540 (1967).

" . . . The rationale of Birnbaum was that the case involved fraudulent mismanagement of corporate shares rather than fraudulent practices in connection with the purchase or sale of securities.

" . . . Considering the purposes underlying the Securities Exchange Act and Section 10(b) and Rule 10b-5, which are to protect investors from fraud, it follows that a seller is injured as much when he suffers a loss on the sale of securities which he has been fraudulently induced to retain as when he is fraudulently induced to sell them." 252 F. Supp. at 219.

The Puretec case, 290 F. Supp. 715 (S. D. N. Y. 1965) expanded the Stockwell rationale to a situation where plaintiffs had been frustrated in their attempt to purchase securities. Discounting an interpretation similarly urged herein by petitioners, the court noted that:

" . . . [T]he construction urged by the defendant would not only fly in the face of that

objective, but render unnecessary the words 'in connection with'. Its effect would be to artificially restrict the statute to proscription of fraud 'in the purchase or sale' rather than 'in connection with' the purchase and sale of a security. The use of the words 'in connection with' indicates that Congress intended to protect against fraud in agreements to buy or sell, as well as with respect to completed sales, provided damages could be shown. Here, for instance, the plaintiffs allege in substance that but for the defendants' fraud, their purchase of the stock of Puretec would have been consummated." 290 F. Supp. at 718-19.

The above cases are mentioned to demonstrate that the Birnbaum rule is not dictated by the language of either section 10(b) or rule 10b-5. This is clear from the provision of the section and rule that fraud only be "in connection with" the purchase or sale of a security and from the

many exceptions which have arisen in avoidance of Birnbaum. Further, the wording of other sections of the Federal Securities Laws may shed light on Congressional intent with respect to a purchaser-seller requirement. [16]

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[16] Section 5(c) of the 1933 Act speaks in terms of offers to sell or offers to buy, Section 12 of that Act establishes a cause of action against a person who "offers or sells" a security, Section 17 of the Securities Act proscribes certain conduct "in the offer or sale of any securities," Section 9(a)(2) of the 1934 Act outlaws some manipulative acts "for the purpose of inducing the purchase or sale" of a security, Sections 9(a)(3) and 9(a)(4) of the Exchange Act proscribe certain manipulative activities if a person is "selling or offering to sell or purchasing or offering to purchase the security," Section 14(e) of the 1934 Act prohibits fraudulent practices "in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request or invitations," Section 15(c)(1) of that Act provides that no broker-dealer may "effect any transaction in, or . . induce the purchase or sale of, any security" in violation of the SEC's rules, a broker-dealer may not "effect any transaction in, or . . . induce or attempt to induce the purchase or sale of, any security" under Section 15(c)(3) of the 1934 Act unless he is in

This erosion in the strict application of the Birnbaum doctrine has been discussed at length by commentators, many of whom have called for its total demise.[17] During the proceedings below and before this Court as amicus curiae, the Securities and Exchange Commission has urged that the Birnbaum rule be abolished in toto.

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conformity with the net capital rules, the short-swing profit provision found in Section 16(b) of the Exchange Act speaks in terms of "purchase or sale," and Section 18(a) establishes a private right of action for false filings when the plaintiff "purchased or sold a security."

17 Comment, The Purchaser-Seller Rule: An Archaic Tool for Determining Standing under Rule 10b-5, 56 Geo. L. J. 1177, 1178 (1968); Note, The Purchaser-Seller Limitation to SEC Rule 10b-5, 53 Cornell L. Rev. 684, 698 (1968); Lowenfels, The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5, 54 Va. L. Rev. 268, 275-276 (1968); Comment, The Decline of the Purchaser-Seller Requirement of Rule 10b-5, 14 Vill. L. Rev. 499, 501-502 (1969); Ruder, Current Developments In the Federal Law of Corporate Fiduciary Relations--Standing to Sue Under Rule 10b-5, 26 Bus. Law, 1289 (1971).

In fact, since entry of the decision below one circuit has wholly abandoned the Birnbaum doctrine. In Eason v. General Motors Acceptance Corporation, 490 F. 2d 654 (7th 1973), there did occur a sale of securities, but the parties to the sale were a defendant and another party. It was a securities transaction in which the plaintiffs were not participants. Plaintiffs were shareholders of Bank Service Corporation (not a party to the action), which issued 7,000 of its shares to defendant Waite in exchange for all of the assets of the latter company. As further consideration for the acquisition, BSC assumed all liabilities of Waite, including notes payable to GMAC for which GMAC required and obtained personal guarantees by plaintiffs. BSC later defaulted on the notes and in a separate action GMAC sued plaintiffs on their guarantees. It was discovered, however, that both Waite and GMAC had made material misrepresentations concerning the true value of the former's assets and plaintiffs then

brought this §10(b) action.

These facts show that the Eason plaintiffs were not purchasers or sellers, nor parties to a contract of purchase or sale, nor were they holders of a right which might be deemed an equivalent to a contractual right to purchase or sell securities. Nevertheless, they were granted standing under §10(b). Upon analyzing the Birnbaum decision and articulating its actual, limited holding, the Court in Eason suggests that the real issue in determining the availability of §10(b) relief should not be one of "standing", but rather, whether plaintiffs are members of the class for whose special benefit Rule 10b-5 was adopted.

The Eason decision then established a test for determining whether a plaintiff comes within the intended class of protected persons:

> "Congress, the Supreme Court, and the [Securities Exchange] Commission have all used the term 'investors' to describe the class of persons protected by Rule 10b-5. Thus,

the statutory authorization for the rule refers to the prohibition of deceptive devices 'for the protection of investors'." (Insert ours) 490 F. 2d at p. 659.

The court, however, does not suggest that the term "investors" be construed in the technical sense of a shareholder. "Investor" is defined in the opinion as someone who has a "stake" or "interest" in the purity and outcome of a securities transaction.

"The plaintiffs in this case were certainly 'investors' in the transaction which is allegedly tainted by fraud. Their interest as stockholders of Bank Service Corporation was apparently sufficient to induce them to execute substantial personal guaranties. As individual guarantors they were direct parties to the transaction in dispute. If, as plaintiffs have alleged, the transaction was consummated in violation of the Rule 10b-5, we believe the plaintiffs, as investors and as prin-

cipals in the transaction, suffered a legal injury which may be redressed by a federal court." 490 F.2d at pp. 659-660.

It is submitted that the plaintiffs in the present case have no less an interest or stake in the securities transaction which is the subject of this action; moreover, the Eason court cited with approval the opinion below in the case at bar. (490 F.2d at p. 660, n. 25.)

While concurring that the Birnbaum decision has been often misinterpreted and thus has created a variety of apparent conflicts, respondent does not believe that a total striking down of Birnbaum is necessary to a disposition of the case at bar. If Birnbaum, as suggested herein, stands for the sole proposition that §10(b) is not a vehicle for correcting corporate mismanagement, then the doctrine has no application here since corporate mismanagement is not made an issue. If Birnbaum legitimately establishes a standing requirement, the respondent submits that it satisfies

that requirement by virtue of its unique causal relationship to the transaction in question.

This Court has stated that Congress intended that securities legislation enacted for the purpose of avoiding frauds should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes. [18] With this in mind and recognizing the line of cases which granted standing to non-purchasers and non-sellers where a causal nexus or contractual relationship existed, the Court below found that respondent had satisfied any such "standing" require-

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18 Affiliated Ute Citizens v. United States, 406 U.S. 128, 151; Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6, 12; SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186.

ment by virtue of its unique relationship to the transaction and its concomitant right or entitlement to purchase the subject shares for a fixed quantity and price and at a specified time. (App. at 138 through 142.) The Court of Appeals held the rights or relationship which flowed from the consent decree served the same function as did the contractual relationship exception in the Puretec, Hentz and Stockwell genre of cases. The Court noted, however, that the amended complaint under review presented a highly unusual situation in which an unyielding insistence upon the existence of a contract to purchase as a prerequisite to relief would subordinate substance to form. (App. at 155.)

A highly unique set of circumstances is presented here. We have the novel, atypical situation in which an issuer of securities is required to make a specific offer, yet an offer which it hopes will go unaccepted. Those circumstances must be considered in application to the broad

remedial function of section 10(b) and rule 10b-5 As stated in Herpich v. Wallace, 430 F. 2d 792, 806-7 (5th Cir. 1970):

> "In determining whether a plaintiff has standing, we search for what will best accomplish the Congressional purpose . . . Thus we construe the 'in connection with the purchase or sale of a security' clause found in both the section and the rule broadly and flexibly to effectuate that purpose . . . The 'purchaser'-'seller' standing requirement is to be similarly construed . . . so that the broad design of the section and the rule is not frustrated by the use of novel or atypical transactions . . ."

Respondent submits that each case brought under section 10(b) should be examined individually with particular concern for whether the fraud alleged is of the type and the plaintiff is of the class intended by Congress to be covered

by 10(b).[19] In this context, respondent would now turn to a more complete and informational description of their unique status and the circumstances which precipitated it.

B. Respondent had a unique right to purchase the securities of Blue Chip Stamps and thereby enjoyed a relationship equivalent to one of contract with petitioners.

The petitioners have consistently sought to place respondent in the extramural position of a mere bystander and thus outside the scope of 10(b) coverage. Respondent believes that the following excerpts from the record of the antitrust proceedings conclusively establish that respondent was anything but a bystander to those proceedings or an unwitting beneficiary of the eventually approved reorganization plan.

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19 SEC v. National Securities, Inc., 393 U.S. 453, 467.

As is alleged in the amended complaint,[20] the "users" had contended that they owned an interest in Blue Chip Stamp Company and sought to have said ownership interest decreed. This claim was consistently agrued by the "users" as amici curiae. Included among the amici curiae was the Attorney General of the State of California, who had entered his appearance on behalf of all retail grocers who were not defendants in the anti-trust action. A portion of the class which respondent represents in this action would be such retail grocers. Also appearing jointly as amicus curiae were California Grocers Association and Certified Grocers of California, Ltd., who also included within their constituency a portion of the respondent class herein.

The material which follows was taken from the official court records and files in the anti-trust action. They were submitted to the Court

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20 App. at 10.

of Appeals in the form of a Supplemental Brief [21] and were relied upon in part [22] by that Court in reaching its decision.

In opposition to the first proposed consent decree the State Attorney General lodged the following objections:

> "It should be borne in mind that, in organizing Blue Chip, in their capacity as majority stockholders and promotors [sic] the defendant retailers caused it to be reported to the retail grocers of the State that Blue Chip would be non-profit to those who promoted it. It was in reliance upon such representation that several thousand retail grocers, not defendants in these proceedings, gave their patronage to Blue Chip, and gave it to such an

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21 This Supplemental Brief is reprinted herein at Appendix "B" to this brief; see, particularly, pages 11 through 35 of said Index.

22 App. at 135, n. 4.

extent that in the aggregate they accounted for not less than 2/3 of the patronage Blue Chip enjoyed during the ten years of its existence. In point of fact, Blue Chip has been operated without profit to its stockholders as such. Consequently, and with fairness to all, Blue Chip's present net assets, tangible and intangible over and above the paid-up value of its share of stock, should be regarded as beneficially belonging to the retail grocers who made it what it is today." (emphasis ours) (Brief of the State of California As Amicus Curiae, p. 42, ll. 19-31, p. 43, ll. 1-4, filed September 27, 1966)

The first proposed consent decree was withdrawn and a second draft was submitted for court approval. The court thereupon requested amici curiae to file briefs if opposition to the plan was found. The Attorney General filed his brief raising the same objection as above. The other amicus curiae filed its brief in which it traced

the history of Blue Chip Stamp company and the representations which had been made to the users and concluded:

"From its inception, Blue Chip was promoted as being run for the benefit of the users whose help was enlisted in its promotion.

"The consenting parties have not addressed any comments to this point. However, much as they would, they cannot close their eyes to the role of the non-defendant users and their very real equity in Blue Chip, its name, its good will and the value of its established business.

"The rights of thousands of California merchants relate not only to the unpaid patronage dividends but also to the other more valuable assets of Blue Chip. So long as any settlement of this case fails to recognize these rights of non-defendant users, the required determination that such settlement is equitable and in the public interest cannot be made."

(emphasis ours) (Reply Brief Of California Grocers Association and Certified Grocers of California, Ltd., As Amicus Curiae, pp. 12-13, filed December 5, 1966)

Thriftimart, Inc., a petitioner herein, was a non-consenting defendant to the second proposed decree and filed a brief in objection which acknowledged the validity of the users' contention:

"Equally important, if not more important, is the fact that the consenting defendants cannot destroy the Blue Chip Stamp Company through the means of the Consent Decree without being guilty of fraud with respect to all of the grocers who relied upon their representations at the organization of Blue Chip and which representations were made repeatedly throughout the years to the present time.

"The grocers relied on these representations and acquired to the extent of their reliance and the extent of the representations

an equitable interest in the business of Blue Chip as equitable members of a de facto co-operative. (emphasis ours) (Reply Brief of Defendant Thriftimart, Inc. To Agrument Of The Sperry And Hutchinson Company, Plaintiff And The Consenting Defendants, p. 19, ll. 22-32, filed December 6, 1966)

The Court then refused to enter the second proposed decree. A third decree was subsequently submitted and approved by the court on June 5, 1967. (App. at 23 through 35.) That court subsequently expressed its understanding of the import of the approved decree:

"The decree herein is designed to limit the powers of Blue Chip and to open up and increase competition in the stamps industry in California, while at the same time preserving the legitimate interests of the users of Blue Chip Stamps." (emphasis ours) (Order Denying Motions To Intervene And To Vacate Consent Decree, p. 18, ll. 6-10, entered Aug-

ust 8, 1967.)

In a brief replying to objections to the proposed plan of reorganization submitted pursuant to paragraph V (App. 27) of the consent decree, the defendants, petitioners herein, said:

". . . The Reorganization Plan has two basic purposes and objectives, namely: (1) To divest control of the company by the present stockholders and broaden the base of ownership so as to dissipate the alleged (and denied) combination and restraint, and (2) to compromise disputed claims which had been asserted by representatives of California Grocers' Association, Certified Grocers, and others in behalf of non-stockholder users. While the existence of such an equitable interest has been denied, it can fairly be said that the claims which had been so asserted were such that the Board of Directors of Blue Chip could properly and in good faith determine that they were worthy of being compro-

mised.

* * *

"There is the additional fact that a valuable consideration moved from the Blue Chip shareholders to present Blue Chip which fully justifies its agreement to protect its shareholders, officers, and directors from liability. Certainly, it was and is in the interest of Blue Chip to settle the Government action without trial. It became apparent that such settlement could not be achieved without offering non-stockholder users an opportunity to acquire an equity interest at a price substantially equivalent to that originally paid by the present stockholders." (emphasis ours) (Reply To Memorandum Of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan Of Reorganization Of Blue Chip Stamp Company Lodged With The Court August 3, 1967, p. 9 ll. 3-17, filed August 22, 1967)

Petitioners have contended herein that the unique interest or right claimed by respondent is a fiction since neither the consent decree nor the plan of reorganization makes mention of any such interest or "bargain" offering. Yet, in a hearing subsequent to Court approval of the consent decree and plan of reorganization, Mr. William W. Alsup on behalf of Blue Chip Stamps conceded that the "users" were intended to be benefited by the consent decree and plan of reorganization thereunder:

> "MR. ALSUP: We do think we need a hearing date obviously to go into the question of who of these users, are entitled to subscribe, assuming Mr. Raley and his group are not, and we take care of these users, as was intended." (emphasis ours) (Reporter's Transcript Of Proceedings, Monday November 4, 1968, Thursday, November 7, 1968, p. 12, ll. 8-12.)

Furthermore, as to the "bargain" aspect of

the offering petitioners would seek to have both sides of the argument. In conjunction with the hearing above mentioned, Mr. Alsup wrote:

> "We cannot agree that the service station operators (a portion of the users represented by respondent herein) could be so lacking in time and financial sophistication that they will be unable to make a bank loan, and particularly so on an offering which it is conceded will be of substantial benefit to them." (insert and emphasis ours) (Memorandum Of Blue Chip Stamps In Support Of Contention That The Raley's Options And Assignments Should Be Declared Invalid, pp. 4-5, filed November 7, 1968.)

The other party-litigant in the anti-trust litigation, the United States Government, through its counsel Stanley E. Disney, Assistant U.S. Attorney, agreed with the assessment that the offering was a "bargain":

"MR. DISNEY: With reference to the decree,

the intent of the decree, he said that distributing 45% of the shares to users was intended basically to achieve two purposes. First to give the user the shares at bargain prices and hope that they would retain those shares;

"MR. DISNEY: But on the basis of the record as it stands I think that many small users had made bad bargains and if there is any way to -- and I think that we intended in the decree to see that they got a good bargain. (emphasis ours) (Reporter's Transcript Of Proceedings, Monday, November 4, 1968, p. 78, ll. 9-17, p. 88, ll. 1-4.)

At the same hearing, Mr. Wallace Howland on behalf of the State Attorney General sounded almost as if he had the present litigation in mind when he addressed the Court as follows:

"MR. HOWLAND: What we have here is a provision in the plan of reorganization that created and brought into existence a right or entitlement in the users of Blue Chip Stamps.

* * *

"And to make sure that the users knew of this right and entitlement there had been conferred upon them by the order of this court, the plan then required advertisements in newspapers, and that a form on which the user could establish his usage would be sent out to all users, and that thirty days after the publication of the first such advertisement the right of users to establish their usage shall terminate.

* * *

"So what we have here, if the court please, is a right, a legally cognizable right conferred upon the user by the plan of reorganization approved by order of this court. It was a right, in effect, to compel Blue Chip Stamp Company to issue its units to a user, and it was a right that each user could either exercise or waive in his discretion." (emphasis

ours) (Reporter's Transcript, supra, pp. 41-43.)

The reason for the rather lengthy exposition of the record in the antitrust action is, hopefully, to demonstrate the clear understanding and intention of the parties with respect to the subject offering. Respondent feels that it is not honest or fair for the petitioners to claim that the offering was not intended to be a bargain in recognition of a right or interest [23] of the users in Blue Chip Stamp Company.

Respondent submits that the court below was justified and correct in finding that the present case presents a highly unusual situation in which

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[23] Respondent submits that this is the type of "intent" or "stake" suggested in the Eason case, supra, which raises the complaining party to the requisite position of an "investor" in the transaction. Moreover, this Court has referred to the injured party as an "investor" as opposed to a purchaser or seller. Affiliated Ute Citizens v. United States, 406 U.S. 128, 151; Superintendent of Insurance v. United States v. United States, 404 U.S. 6, 12.

an unyielding insistence upon the existence of a contract to purchase as a prerequisite to relief would subordinate substance to form. (App. at 155.)

C. Granting standing to respondent does not conflict with the Securities Act of 1933 or create an impossible burden for furture issuers of securities.

Peitioners make two alarmist arguments: (1) that the decision below opens the floodgates to unlimited 10(b) actions and (2) creates an impossible burden for future prospectus draftsmen in light of the disclosure policy of the Securities Act of 1933.

Even if one were to assume that an affirmation of the Court of Appeals decision would expose future offerors of securities to draconian damage claims and strike suits, as suggested by Justice Hufstedler in her dissenting opinion (App. at 151, respondent submits that such a doomsday prediction is not a relevant or justifiable basis

for denying relief to respondent herein. Although 10b-5 may well be the most litigated provision in the federal securities field, it has never been suggested that the increase in 10(b) actions is due to the creation of exceptions to the Birnbaum rule, such as in the aborted purchaser or seller cases cited infra. Petitioners are, in effect, suggesting that the defrauded party should be the one to suffer rather than the perpetrators of the fraud.[24]

The Court in Eason v. General Motors Acceptance Corporation, 490 F.2d 654 (7th Cir. 1973) considered the policy argument that further erosion or an abandonment of Birnbaum would lead to an unmanageable flood of federal litigation. In fact, the Eason court explicitly referred to Justice Hufstedler's dissent when it held:

> "The volume of 10b-5 litigation has already expanded dramatically and will no doubt

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[24] 490 F.2d 654, 661, n. 25.

continue to do so whether or not the purchaser-seller limitation is rejected. The extent to which a refusal to adhere to Birnbaum will affect that volume is really a matter of speculation The fact that the purchaser-seller limitation is unacceptable does not mean that there will be no limit of any kind of the availability of private relief. For in each case the plaintiff will have to demonstrate membership in the 'special class' protected by Rule 10b-5 and injury as a direct consequence of the alleged violation. The number of parties who may invoke Rule 10b-5 without the purchaser-seller limitation may not differ materially from the number who would recover by persuading a court to interpret the purchaser-seller concept flexibly." 490 F. 2d at 660.

The Eason decision also notes that this Court expressed no such fear in its expansion of 10(b) coverage in Superintendent of Insurance v. Bankers

Life & Casualty Co., 404 U.S. 6, 24. [25]

The decision below, however, does not subject future issuers to unlimited 10(b) damage actions. Respondent stresses that the facts and circumstances of the case at bar, as recognized by the majority opinion, are unique and can be properly restricted to this singular offering. Respondent has never suggested that permitting it to have its day in court would cause a rent in the the curtain which repels totally speculative claims of bystanders to securities transactions.

An equally unjustified but calamitous consequence raised by petitioners is that future prospectus draftsmen will find it an impossible burden to reconcile the disclosure policy of the Securities Act of 1933 with an unbridled opening of the class of 10(b) claimants. But, the 1933 Act merely requires that an issuer disclose ad-

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[25] 490 F.2d 624, 661.

verse factors connected with an offering; it does not mandate or sanction over-emphasis of partially true or wholly illusory negative factors, as is alleged in the present action. [26] As petitioners state in their brief, the 1933 Act expresses a policy of full disclosure, not false pseudo-disclosure.

Interestingly, petitioners cite [27] as authority for this supposed irreconcilable conflict between the two Acts certain legislative history (H.R. Rep. No. 85, 73d Cong., 1st Sess. 8 (1933)), which explicitly states that:

> "The purpose of the 1933 sections is to secure for potential buyers the means of understanding the intricacies of the transaction into which they are invited." (emphasis ours)

Because of the alleged fraud of petitioners,

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26 App. at 15 through 17.

27 Petitioners' brief at pp. 37-38.

respondent never technically became more than a potential buyer. It is submitted, therefore, that petitioners have not satisfied even the basic policy of the 1933 Act. If a true conflict is created between the 1934 and 1933 Act it certainly has not troubled the department charged with the administration and enforcement of those laws. As has been mentioned above, the Securities and Exchange Commission has urged that this Court go a step beyond the position taken by respondent and totally abolish the Birnbaum doctrine. Again, respondent is willing to concede that the Court of Appeals' decision is applicable only to the present case; but, even if it were not and it thereby created a different problem for future issuers, such a difficulty is not one which is insurmountable for the Commissioner to alleviate by appropriate regulation.

As was noted by this Court in Flast v. Cohen, 392 U.S. at 94, n. 9, where the standing of a taxpayer was challenged, fears of overburdening

the courts are mitigated by the ready availability of the devices of class actions and joinder under the Federal Rules of Civil Procedure and by the increased ability of the federal courts, through experience in recent years, to cope effectively with "huge litigations and redundant actions."

Petitioners' contention that respondent should be foreclosed from pursuing this action because its claim for damages is too speculative [28] is not properly an issue in a motion to dismiss for lack of standing. The rule denying recovery of speculative damages is applicable only where there is

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28 Petitioners also question whether respondent has alleged a compensible loss under 10(b) in that because there has been no technical purchase or sale there has been, thus, no "out of pocket" loss. 15 U.S.C. §78bb, however, provides that the measure of damages in a §10(b) action shall be "actual damages" sustained as a result of the act complained of. This further illustrates the enigmatic position of petitioners, who would seek evasion of the anti-fraud purpose of §10(b) because they were so "successful" as to dissuade respondent from purchasing any of the offered securities.

uncertainty as to the reality of damages, rather than uncertainty as to their amount or measure As was held in Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, 563-65 (1931), where it is certain that damages have been suffered the defendant will not be absolved from liability because of the uncertainty of the amount but the trier of fact will make the most intelligent estimate of the amount of damages to which the plaintiff is entitled as the nature of the case permits. [29]

Furthermore, the respondent's claim for damages is not the sole relief requested. Respondent has prayed in the alternative for the right to purchase the offered securities of Blue Chip Stamps at the price and upon the terms specified

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29 See, also, Commerce Reporting Company v. Puretec, Inc., 290 F. Supp. 715, 719 (S.D. N.Y. 1968); Site v. Leasco Data Processing Equipment Corp., 332 F. Supp. 544 (E.D.N. Y. 1971).

in the subject offering (App. at 22).

II.

RESPONDENT HAS NOT CONTENDED NOR DOES THE COURT OF APPEALS OPINION HOLD THAT STANDING HEREIN HAS ANY RELEVANT CONNECTION WITH ENFORCEMENT OF A CONSENT DECREE BY A THIRD PARTY.

There is nothing express or implicit in the opinion below which suggests that the respondent seeks to enforce the prior consent decree. Respondent's emphasis upon the facts and circumstances surrounding the consent decree and the Court of Appeals' discussion thereof serve as important historical and causal background concerning the unique status which respondent enjoyed with respect to the subject "bargain" offering. Respondent prefers to characterize the consent decree not as the alleged "right" itself, but rather

as the source from which a legally cognizable right eventually flowed.

Although the case of United States v. Armour & Co., 402 U.S. 673 (1971) is correctly cited for the proposition that a non-party to a consent decree may not enforce that decree directly or in a collateral proceeding, respondent submits that this principle has little to do with the case at bar. The majority opinion below best articulates the distinction respondent seeks to establish:

> "The rule referred to does not bar the claim before us, however. This claim rests upon the theory that plaintiff-appellant was damaged by a violation of the Securities Exchange Act of 1934 and Rule 10b-5 prohibiting fraud in connection with the purchase or sale of securities. The fact that the securities transaction that is the subject matter of the claim was mandated by the consent decree does not immunize defendant-appellees from the statutes and rules regulating securities

transactions. Plaintiff-appellant relies upon a breach of a duty imposed by these statutory anti-fraud provisions, not upon a breach of a duty imposed by the consent decree. (App. at 141-142, n. 4.)

Had the court reasoned that respondents were hereby attempting to enforce the decree it would not have analyzed its status as one which is the "functional equivalent" of a contractual relationship. If respondent were enforcing or entitled to enforce the consent decree, an actual contractual relationship would have been established. Such is not the import of the court's language or the thrust of respondent's contentions.

CONCLUSION

For the foregoing reasons the decision of the Court of Appeals should be affirmed and the case

remanded to the District Court for further proceedings.

Respectfully submitted,

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January 29, 1975

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APPENDIX A

APPENDIX A

15 U.S.C. §78bb:

(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of.

APPENDIX B

APPENDIX B

UNITED STATES COURT OF APPEAL

FOR THE NINTH DISTRICT

MANOR DRUG STORES, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps, Plaintiff-Appellant, vs. BLUE CHIP STAMPS, BLUE CHIP STAMP COMPANY, LUCKY STOES, INC., MARKET BASKET, PURITY STORES, INC., RALPHS GROCERY COMPANY, SAFEWAY STORES, INC., THRIFTIMART, INC., THRIFTY DRUG STORES CO, INC., VON'S GROCERY CO., ROBERT E. ALEXANDER, DONALD A. KOPPEL, LEONARD H. STRAUS, WILLIAM F. RAMSEY, ROBERT E. LAVERTY, RICHARD RALPHS, JOHN R.	)	No. 71-2223 PLAINTIFF-APPELLANT'S SUPPLEMENTAL BRIEF

NIVEN, FRED VON DER AHE,)
)
Defendants-Appellees.)
)

I. PRELIMINARY STATEMENT

In response to the Court's order, plaintiff-appellant herewith submits its brief regarding the recent Ninth Circuit decision in Mount Clemens Industries, Inc. v. Bell, No. 71-1318, decided June 28, 1972. The Securities Exchange Commission, which has appeared heretofore in this proceeding as amicus curiae, has likewise been requested to file a brief. It is plaintiff-appellant's understanding from conversations with Securities Exchange Commission's counsel that their brief will primarily urge that the Mount Clemens decision be rejected in toto by this Court. While we join in the brief of the Securities Exchange Commission and the agruments raised therein, at the same time we feel that the Mount Clemens case supports the posi-

tion that has been consistently urged by plaintiff-appellant herein. Although we feel that the Mount Clemens case and the one at bar present dissimilar facts and therefore necessarily different questions before the Court, we nevertheless feel that much of the language of the Mount Clemens opinion and the crux of the rationale support and affirm this plaintiff-appellant's contentions.

Although we share in the Security Exchange Commission's disappointment over the Court's refusal to disaffirm the Birnbaum doctrine in toto, we do not find the Mount Clemens decision to be a hindrance in any other respect. The Mount Clemens case is easily distinguished from the one at bar. There, certain corporate securities were offered at an ordinary public auction. Plaintiffs were merely members of the general public interested in purchasing the subject securities. Defendant represented to the plaintiffs

that the securities were worthless and it is alleged that the plaintiffs were thereby induced not to bid at the sale. There was no allegation by the plaintiffs that they enjoyed any status or had any special rights other than that of all other members of the public. There was no previous relationship between the parties which gave rise to any duty on the part of the defendant or any "right" on behalf of the plaintiffs to engage in the securities transaction. The Court in Mount Clemens made the following observation which we contend to be of significant importance:

> Plaintiffs were not even induced to refrain from accepting an outstanding offer" (emphasis ours)(Slip. Op. at page 10, footnote 11.)

The gravamen of the amended complaint in the present case concerns and alleges the very existence of an outstanding offer. (Amended Complaint, paragraph XVI, R.13) Additionally, it is alleged in our Amended Complaint that the "Users"

herein enjoyed a unique status, which status "Prompted The Plan and the offering." (Amended Complaint, paragraph X, R. 6-7, l. 28)

We contend, therefore, that the crucial question before this Court is whether or not the plaintiffs-appellants herein possessed a special and exclusive right or owned an equitable interest within the protective provisions of Section 10(b). If the Court concludes that the complaint does not allege with sufficient clarity the special right of plaintiff's to purchase the offered stock, plaintiffs ask leave to amend the complaint to conform to the following facts.[1]

In light of certain of the language in the Mount Clemens decision and by virtue of certain deductions the undersigned has made as a result of the Court's questions at the time of oral argument

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1 . . . . (T)he accepted rule (is) that a complaint should not be dismissed for failure to state a claim unless it appears beyond a reasonable doubt that the plaintiff can prove no set of factors in support of his claim which would entitle him to relief." Conley vs. Gibson, (1957). 355 U.S. 41, 46, 78 S.Ct. 99, 102, 2L. Ed. 2d 80.

of this matter, this brief will be limited to an elucidation of the status of the plaintiff-appellant at the time of the subject violation of Section 10 (b).

II. THE MOUNT CLEMENS DECISION SUPPORTS PLAINTIFF-APPELLANT'S CONTENTION THAT IT HAS "STANDING" UNDER SECTION 10 (b) OF THE SECURITIES EXCHANGE ACT OF 1934.

Initially, it must be noted with much importance that the Mount Clemens opinion specifically adopts the view which has been persistently urged by plaintiff-appellant throughout these proceedings, to wit: that a plaintiff is not dependent upon an actual purchase or sale in order to state a cause of action under Section 10(b). Specifically, the Court stated:

> "These allegations clearly reveal that plaintiff never actually purchased or sold the Missile stock. Yet that circumstance does not end our inquiry, for under the liberal inter-

pretation that has sometimes attended the application of the Birnbaum Doctrine there have been cases in which standing has been afforded to persons who, even though not actual purchasers or sellers, have been deemed to have the required status. (citing cases)" (Slip. Op. at page 9)

Consequently, the Mount Clemens decision lays to rest a major issue regarding which both appellant and appellee devoted much of their previous briefs. Therefore, despite defendants-appellees' repeated arguments to the contrary, the amended complaint here is not defective because it admittedly asserts that the "Users" were non-purchasers.

There can also be no question that the Mount Clemens decision holds that lacking the status of an actual purchaser or seller the plaintiff must demonstrate that it enjoys some other status for which relief should be afforded. The Court rec-

ognized that all of the cases which adopted the non-technical or liberal interpretation of the 10(b) (b) standing language found that the plaintiff enjoyed the status of "a party to a prior agreement to purchase or sell" securities. The Mount Clemens Court observed that the cases which fall into the "aborted purchaser-seller cases" ((Opper vs. Hancock Secs. Corp., 367 F. 2d 157 92d Cir.), Aff'g. 250 F. Supp. 668 (S. D. N. Y. 1968); Goodman vs. H. Hentz & Co., 265 F. Supp. 440 (N. D. Ill. 1967); Stockwell vs. Reynolds & Co., 252 F. Supp. 215 (S. D. N. Y. 1965)) all presented evidence of such a prior agreement or "contractual relationship". At the same time, the Court noted:

> "We recognize that the term 'contract' in Sections 3(a) (13) and 3(a) (14) must be given a broad, liberal interpretation (citing cases)." (Slip. Op. at page 11, footnote 12.)

As is obvious from the very title of the cate-

gory of such cases, each of the plaintiffs in the "aborted purchaser-seller" cases was frustrated from consummating a specific purchase or sale of securities. The courts, of course, did not deny these plaintiffs relief merely because they were never able to engage in the particular securities transaction. Rather, they were afforded standing under Section 10(b) because they had a right to participate in the transaction in question. In those cases above cited, the rights of the plaintiffs flowed from an agreement or a contract. We submit that the plaintiff-appellant herein similarly had a right to engage in a specific transaction. That right emanates from a court decree, based upon a stipulation (contract) in the government anti-trust case. The decree singled out the plaintiffs ("Users") and gave them a special right, distinct, unique and exclusive from the "man on the street" plaintiff in the Mount Clemens case.

We wish, therefore, to present to this Court the following historical, legal data which is the font of this entire litigation and from which flowed the status of the plaintiff-appellant ("Users"). We therefore request that this Court take judicial notice of those citations and quotations from the record of the previous anti-trust lawsuit. 2

III. THE RECORDS AND PLEADINGS OF THE GOVERNMENT ANTI-TRUST SUIT ESTABLISH THAT "USERS" HAD A "RIGHT" TO PURCHASE BLUE CHIP STAMP'S SECURITIES

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2. Federal Appellate Court may take judicial notice of matters, even though not brought to the attention of the lower court, where necessary to show the impropriety of the lower court decision. International Brotherhood of Teamsters, Chauffers, Warehousemen, and Helpers of America vs. Zantop Air Transport Corp., 394 F.2d 36 (6th Cir. 1968)

As is alleged in the Amended Complaint (R. 4-6) and has been briefed and argued in these proceedings, the basis of plaintiff-appellant's claim under Section 10(b) stems from the Consent Decree entered June 5, 1967 by the United States District Court in United States of America vs. Blue Chip Stamp Company, et al., No. 63-1552. This was a civil anti-trust action in which it was alleged in substance that the defendants had conspired to restrain competition in the trading stamp industry in California and had obtained an illegal monopoly therein. A chronological history of that litigation establishes the genesis of the "Users" "rights" herein and the total fallacy in the defendants' contention that the "Users" had no more than an "opportunity" to purchase the securities in question.

The records in that case reveal that:

On July 29, 1966, the United States Government as plaintiff and all but two of the defend-

ants therein agreed to and lodged with the Court a proposed consent decree. Said decree made no provision concerning any offering of securities to "Users"; nor was there any mention or recognition of said "Users".

The two non-consenting defendants were Thriftimart, Inc. and Market Basket. They were most adamant in their refusal to stipulate to the proposed consent decree and urged that the implications of any such decree would have a tremendous impact on the grocery and other retail industries in California which subscribed to Blue Chip's stamp program and the very economy of California in general. Thriftimart therefore petitioned the Court that the "retail customers" of Blue Chip be brought into the action as indispensible parties plaintiff or parties defendant (Motion of Thriftimart, Inc. For Order Re Proposed Final Judgment By Stipulation, filed July 29, 1966.)

The Court thereupon permitted the entry into the case by various amici curiae, among which was the Attorney General of the State of California. The Attorney General entered his appearance on behalf of all retail grocers of California who were non-defendants and in his capacity as parens patriae. (Amended Complaint, paragraph IX, R. 23) The above-mentioned retail grocers therefore included a large number of the plaintiff-"Users" herein. On September 27, 1966, the California Attorney General filed his brief in opposition to the entry of the first proposed consent decree. Therein he stated:

> "It should be borne in mind that, in organizing Blue Chip, in their capacity as majority stockholders and promotors [sic] the defendant retailers caused it to be reported to the retail grocers of the State that Blue Chip would be non-profit to those who promoted it. It was in reliance upon such representation

that several thousand retail grocers, not defendants in these proceedings, gave their patronage to Blue Chip, and gave it to such an extent that in the aggregate they accounted for not less than 2/3 of the patronage Blue Chip enjoyed during the ten years of its existence. In point of fact, Blue Chip has been operated without profit to its stockholders as such. Consequently, and with fairness to all, Blue Chip's present net assets, tangible and intangible over and above the paid-up value of its share of stock, should be regarded as beneficially belonging to the retail grocers who made it what it is today." (emphasis ours) (Brief of the State of California As Amicus Curiae, p. 42, ll. 19-31, p. 43, ll. 1-4, filed September 27, 1966)

On October 3, 1966, the government-plaintiff withdrew its approval of the proposed consent decree.

On October 28, 1966, a second proposed consent decree was lodged with the Court. This decree was substantially the same as its predecessor and again contained no provision for an offering of securities to non-defendant "Users" or otherwise any mention or recognition of that class. On October 28, 1966 by its Order of same date, the Court instructed defendants and amici curiae to file objections to the second proposed consent decree.

On November 15, 1966, the State Attorney General filed its brief objecting to the proposed decree. Again he objected to the decree's failure to recognize the beneficial or equitable interest of the non-defendant "Users":

> "Blue Chip's present net assets, tangible and intangible, over and above the paid-up value of its shares of stock, should be registered as beneficially belonging, in proportion to their patronage, to all the retailers who made it

what it is today." (Brief Of The State Of California As Amicus Curiae, p. 77, ll. 8-12, filed November 15, 1966)

As an appendix to his brief, the Attorney General submitted a proposed consent decree which provided that upon dissolution of Blue Chip Stamp Company there be a distribution of its assets on a pro rata basis to the non-defendant "Users".

Also appearing in an amicus curiae stature were jointly, the California Grocers Association and Certified Grocers of California, Ltd. On December 5, 1966, they filed their brief in opposition to the second proposed consent decree and after tracing the origin and development of the Blue Chip Stamp Company and the representations which had been made to the non-defendant "Users", urged the Court:

"Out of this abundance of successful cooperative experience, the independent retailers of California believe that Blue Chip Stamp

Company should be controlled and owned by the users, directly or indirectly." (emphasis ours) (Memorandum On Behalf Of California Grocers Association And Certified Grocers Of California, Ltd., As Amicus Curiae, p. 37, ll.19-22, filed November 14, 1966)

Thriftimart, Inc. once again objected and filed its brief in opposition to the second proposed decree. Reiterating its concern that the "Users" be joined as indispensable parties, Thriftimart in support of its contentions noted the aforementioned claims by the amici curiae:

"As a result of this position, Certified Grocers and the California Grocers Association have taken the position that the assets of Blue Chip are held in trust for the users to the extent which these representations warrant." (emphasis ours) (Objections And Opposition Of Thriftimart, Inc.) To Entry Of Second

Proposed Consent Decree, Lodged October 28, 1966.)

The government-plaintiff and the consenting defendants filed briefs in response to the foregoing memoranda and, in general, urged that the proposed decree was fair and equitable to all concerned and that there was no just reason for delay in its entry.

A reply brief by California Grocers Association and Certified Grocers of California, Ltd. commented upon the plaintiff's and defendants' briefs and further emphasized the unrewarded claim of the non-defendant "Users":

> "From its inception, Blue Chip was promoted as being run for the benefit of the users whose help was enlisted in its promotion.
>
> "The consenting parties have not addressed any comments to this pooint. However, much as they would, they cannot close their eyes to the role of the non--defendant users and

their very real equity in Blue Chip, its good will and the value of its established business.

"The rights of thousands of California merchants relate not only to the unpaid patronage dividends but also to the other more valuable assets of Blue Chip. So long as any settlement of this case fails to recognize these rights of non-defendant users, the required determination that such settlement is equitable and in the public interest cannot be made." (emphasis ours) (Reply Brief Of California Grocers Association And Certified Grocers Of California, Ltd., As Amicus Curiae, pp. 12-13, filed December 5, 1966)

Thriftimart, Inc., also replied to the briefs of the plaintiff and the consenting defendants in support of the second proposed consent decree, and although a defendant in the case at bar, it would appear from the following language of its

brief that Thriftimart fully aligned itself with the "Users":

> "Equally important, if not more important, is the fact that the consenting defendants cannot destroy the Blue Chip Stamp Company through the means of the Consent Decree without being guilty of fraud with respect to all of the grocers who relied upon their representations at the organization of Blue Chip and which representations were made repeatedly throughout the years to the present time.
>
> "The grocers relied on these representations and acquired to the extent of their reliance and the extent of the representation an equitable interest in the business of Blue Chip as equitable members of a de facto co-operative." (emphasis ours) (Reply Of Defendant Thriftimart, Inc. To Argument Of The Sperry And Hutchinson Company, Plaintiff And The Con-

senting Defendants, p. 19, ll. 22-32, filed December 6, 1966)

Thriftimart went on to state:

"It was on the basis of these representation oft repeated that the grocers of California came into the Blue Chip plan in order that they might remain competitive with those having the Sperry and Hutchinson franchised S & H green stamp. All went into the program. They made it a success. It was the money of the members as much as the backing of the stockholders that made possible Blue Chip and saved the grocery industry from monopoly. These facts, among others, are the background for the position of Certified Grocers and the California Grocers Association that they have a beneficial interest in this company. (emphasis ours) (Reply Of Defendant Thriftimart, Inc. To Argument Of The Sperry And Hutchinson Company, Plain-

tiff And The Consenting Defendants, p. 24, ll. 6-15, filed December 6, 1966)

After three days of oral argument, the Court refused to enter the second proposed consent decree. (Court Minutes of December 15, 1966) There can be no doubt as to Judge Ferguson's reason for declining to sign the decree as is evidenced by his following statement in a hearing on objections to a third proposed consent decree:

"THE COURT: I have read it (third proposed consent decree) hundreds of times. Please don't make me go through it again.

"Answer my question, as a pragmatic service station operator, if you can convince me that this decree is going to do injury to you I probably won't sign it. But you are going to have to convince me on that level.

"MR. DOWNEY: That's right.

"THE COURT: The grocerystore people convinced me last time. Now if you, as a ser-

vice station operator, can convince me this time more power to you. But you are not going to convince me on any other kind of approach." (insert and emphasis ours) (Reporter's Transcript of Proceedings of June 5, 1967, p. 466, ll. 5-17)

* * *

"THE COURT: There is a difference, there is a difference. Mr. Howland (Assistant State Attorney General) convinced me last time about the grocery stores." (insert and emphasis ours) (Reporter's Transcript of Proceedings of June 5, 1967, p. 477, ll. 12-14)

On April 28, 1967, a third proposed consent decree was lodged with the Court. This, of course, was the Consent Decree which was eventually signed on June 5, 1967 and thereafter put into operation. (Amended Complaint, paragraph VI, R. 4) It was pursuant to paragraph V of said Consent

Decree (R. 22), in which the defendants were ordered to present to the Court within 60 days a plan of reorganization of Blue Chip Stamp Company, that the defendants filed and had approved the plan of reorganization (R. 35) containing the offer to "User".

All of the parties and aforementioned amici curiae approved the Consent Decree. Certain other amici curiae objected to it (e.g. Independent California Service Station Operators, Gold Bond Stamps, etc.). In reply to their objections, the plaintiff-government commented on the considerations which had been involved in drafting the third proposed consent decree:

> "The proposed Final Judgment lodged with the Court on April 28, 1967 was agreed to by the United States only after long and complicated negotiations extending over two years In drafting this decree, earnest consideration was given to the views of the Court express-

ed on December 15, 1966. Oral and written views of counsel for defendants, the State of California, Certified Grocers' Association, all of whom approve the proposed decree, were received and considered by the Department of Justice, as well as the views of all parties interested in opposing the decree. (Plaintiff's Memorandum In Reply To Memorandum Filed In Opposition To Proposed Final Judgment Lodged With The Court April 28, 1967, p. 5, ll. 12-21, filed May 26, 1967)

In seeking Court approval of the Reorganization Plan and in defense of their "bargain offering" to "Users", the defendants stated:

" . . . The Reorganization Plan has two basic purposes and objectives, namely: (1) To divest control of the company by the present stockholders and broaden the base of ownership so as to dissipate the alleged (and denied) combination and restraint, and (2) to comp-

romise disputed claims which had been asserted by representatives of California Grocers' Association, Certified Grocers, and others in behalf of non-stockholder users. While the existence of such an equitable interest has been denied, it can fairly be said that the claims which had been so asserted were such that the Board of Directors of Blue Chip could properly and in good faith determine that they were worthy of being compromised." (emphasis ours) (Reply To Memorandum of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan Of Reorganization Of Blue Chip Stamp Company Lodged With The Court August 3, 1967), p. 9, ll. 3-17, filed August 22, 1967)

If it is not clear from the above, it is manifestly so from the following, that the present defendants recognized the "right" or equitable in-

terest of the "Users" and incorporated them into the plan of reorganization and Consent Decree:

> "There is the additional fact that a valuable consideration moved from the Blue Chip shareholders to present Blue Chip which fully justifies its agreement to protect its shareholders, officers, and directors from liability. Certainly, it was and is in the interest of Blue Chip to settle the Government action without trial. It became apparent that such settlement could not be achieved without offering non-shareholder users an opportunity to acquire an equity interest at a price substantially equivalent to that originally paid by the present stockholders." (emphasis ours)

(Reply To Memorandum Of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan Of Reorganization Of Blue Chip Stamp Company Lodged With The Court August 3, 1967, p. 7, ll. 7-8, filed

August 22, 1967)

If there be any doubt that the Court, too, recognized this equitable interest in the "Users" and intended that it be accounted for in the Consent Decree, such doubt is allayed by the Courts' following statement:

> "The decree herein is designed to limit the powers of Blue Chip and to open up and increase competition in the stamp industry in California, while at the same time preserving the legitimate interests of the users of Blue Chip Stamps." (emphasis ours) (Order Denying Motions To Intervene And To Vacate Consent Decree, p. 18, ll. 6-10, entered August 8, 1967)

In addition, the very fact that the offering of securities to the "Users" was at a bargain price compels the conclusion that the defendants recognized that the "Users" possessed the claimed equitable interest or right. Despite defendants'

contentions to the contrary, there is no question, as will be seen infra, that the offering to the "Users" was intended to be and was, in fact, at a "bargain".

In a hearing subsequent to Court approval of the Consent Decree and Plan of Reorganization, Mr. William W. Alsup on behalf of Blue Chip Stamps conceded that the "Users" were intended to be benefitted by the Consent Decree and plan of reorganization thereunder:

> "Mr. ALSUP: We do think we need a hearing date obviously to go into the question of who of these users are entitled to subscribe, assuming Mr. Raley and his group are not, and we take care of these users, as was intended." (emphasis ours) (Reporter's Transcript Of Proceedings, Monday, November 4, 1968, Thursday, November 7, 1968, p. 12, ll. 8-12)

Furthermore, it was conceded that the offer-

ing was to be of substantial benefit to the "Users":

"In our reply filed August 22, 1967 to the memorandum in opposition of Independent California Service Station Operators we discussed the financing arrangements available through the Bank of America and stated in part:

* * *

"'If the service station operators are, even remotely, as unsophisticated financially as counsel suggest, then if subscription rights were transferable there could be considerable danger they could be persuaded to give up their right to subscribe for a grossly inadequate price.

"'Certainly there is nothing illegal in restricting transferability of a rights offering and, since there is no restraint on the stock itself there is no restraint on alienation of property, i.e., the stock and debentures.

"'We cannot agree that the service station operators could be so lacking in time and financial sophistication that they will be unable to make a bank loan, and particularly so on an offering which it is conceded will be of substantial benefit to them.'" (emphasis ours) Memorandum Of Blue Chip Stamps In Support Of Contention That The Raley's Options And Assignments Should Be Declared Invalid, pp. 4-5, filed November 7, 1968)

The other party-litigant in the anti-trust litigation, the United States Government, through its counsel, Stanley E. Disney, Assistant U.S. Attorney, agreed with the assessment that the offering was a "bargain":

"MR. DISNEY: But on the basis of the record as it stands I think that many small users had made bad bargains and if there is any way to -- and I think that we intended in the decree to see that they got a good bargain."

(emphasis ours) (Reporter's Transcript Of Proceedings, supra, p. 78, ll. 9-17.)

At the same hearing, Mr. Wallace Howland on behalf of the State Attorney General sounded almost as if he had the present litigation in mind when he addressed the Court as follows:

"MR. HOWLAND: What we have here is a provision in the plan of reorganization that created and brought into existence a right or entitlement in the users of Blue Chip Stamps.

* * *

"And to make sure that the users knew of this right and entitlement there had been conferred upon them by the order of this court, the plan then required advertisements in, newspapers, and that a form on which the user could establish his usage would be sent out to all users, and that thirty days after the publication of the first such advertisement the right of users to establish their us-

age shall terminate.

* * *

"So what we have here, if the court please, is a right, a legally cognizable right conferred upon the user by the plan of reorganization proved by order of this court. It was a right, in effect, to compel Blue Chip Stamp Company to issue its units to a user, and it was a right that each user could either exercise or waive in his discretion." (emphasis ours) (Reporter's Transcript, supra, pp. 41-43)

III CONCLUSION

We therefore submit that it is clear from the foregoing exposition that: the "Users" emphatically asserted in the anti-trust action an equitable interest or right, that interest or right was recognized by the Court, the defendants, the government-plaintiff, and the various amici curiae on behalf of the "users" incorporated in the

Consent Decree and Plan of Reorganization thereunder, and that the "Users" must be afforded the appropriate relief under Section 10(b) in protection of that interest or right.

Thus, we repsectfully request that this Court reverse the Order below and permit this matter to be heard on its merits.

Respectfully submitted,

Dated: August 15, 1972 Brandlin, Ryan & McAllister

By: _____
James E. Ryan

Attorneys for Plaintiff-Appellant

INDEX

Page

Question presented 2

Interest of the Securities and Exchange Commission 2

Statement 2

Summary of argument 5

Arguments

The victim of deceptive activities in connection with the purchase or sale of securities should be able to recover his demonstrable damages whether or not he has purchased or sold securities 8

A. Section 10(b) and Rule 10b-5 protect "any person" against deceptive devices material to an investment decision 10

B. There is an implied civil remedy on behalf of all persons injured by violations of Rule 10b-5, including those who have neither purchased nor sold securities 17

C. This Court should not adopt the *Birnbaum* rule as a method to limit the class of potential plaintiffs 24

Conclusion 33

CITATIONS

Cases: Page

A. T. Brod & Co. v. *Perlow*, 375 F.2d 393 ..... 10, 15, 32
Affiliated Ute Citizens v. *United States*, 406 U. S. 128 ..... 7, 10, 18, 25, 26
Association of Data Processing Organizations, Inc. v. *Camp*, 397 U.S. 150 19
Berko v. *Securities and Exchange Commission*, 316 F.2d 137 16
Birnbaum v. *Newport Steel Corp.*, 193 F.2d 461, certiorari denied, 343 U.S. 956 ..... 4, 5, 6, 7, 8, 11
Britt v. *Cyril Bath Co.*, 417 F.2d 433 21
City National Bank v. *Vanderboom*, 422 F.2d 221, certiorari denied, 399 U.S. 905 9
Commerce Reporting Co. v. *Puretec, Inc.*, 290 F. Supp. 715 10
Conley v. *Gibson*, 355 U.S. 41 2
Crane Co. v. *Westinghouse Air Brake Co.*, 419 F.2d 787, certiorari denied, 400 U.S. 822 32
Drachman v. *Harvey*, 453 F.2d 722, reversed on rehearing *en banc*, 453 F.2d 736 31-32
Eason v. *General Motors Acceptance Corp.*, 490 F.2d 654, certiorari denied, 416 U.S. 960 ..... 9, 20, 24, 30
Ellis v. *Carter*, 291 F.2d 270, dismissal affirmed, 328 F.2d 573 10
Fischman v. *Raytheon Mfg. Co.*, 188 F.2d 783 ..... 18, 20
Flast v. *Cohen*, 392 U.S. 83 19

Cases—Continued

	Page
Fratt v. *Robinson*, 203 F.2d 627	18, 20
Goodman v. *H. Hentz & Co.*, 265 F. Supp. 440	10
Greater Iowa Corp. v. *McLendon*, 378 F. 2d 783	12
Greenstein v. *Paul*, 400 F.2d 580	31
Hanly v. *Securities and Exchange Commission*, 415 F.2d 589	17
Hardin v. *Kentucky Utilities Co.*, 390 U.S. 1	19
Hooper v. *Mountain States Securities Corp.*, 282 F.2d 195, certiorari denied, 365 U.S. 814	9, 18, 20
Hughes v. *Securities and Exchange Commission*, 174 F.2d 969	16
International Controls Corp. v. *Vesco*, 490 F.2d 1334, certiorari denied, 417 U.S. 932	9, 32
Iroquois Industries, Inc. v. *Syracuse China Corp.*, 417 F.2d 963	9, 31
J. I. Case Co. v. *Borak*, 377 U.S. 426	2, 6, 7, 18, 21, 22, 23, 31
James v. *Gerber Products Co.*, 483 F.2d 944	9, 32
Kahan v. *Rosenstiel*, 424 F.2d 161, certiorari denied *sub nom. Glen Alden Corp.* v. *Kahan*, 398 U.S. 950	21
Kardon v. *National Gypsum Co.*, 69 F. Supp. 512	19
Kerbs v. *Fall River Industries, Inc.*, 502 F.2d 731	9
Kuehnert v. *Texstar Corp.*, 412 F.2d 700	16
Lanasa Fruit S.S. & I. Co. v. *Universal Insurance Co.*, 302 U.S. 556	12

Cases—Continued

	Page
Landy v. *Federal Deposit Insurance Corp.*, 486 F.2d 139, certiorari denied, 416 U.S. 960	9
M. L. Lee & Co. v. *American Cardboard & Packaging Corp.*, 36 F.R.D. 27	10
McClure v. *Borne Chemical Co.*, 292 F.2d 824, certiorari denied, 368 U.S. 939	11
Mills v. *Electric Auto-Lite Co.*, 396 U.S. 375	2, 6, 22
Mount Clemens Industries, Inc. v. *Bell*, 464 F.2d 339	5
Mutual Shares Corp. v. *Genesco, Inc.*, 384 F.2d 540	21, 32
N. Sims Organ & Co., Inc. v. *Securities and Exchange Commission*, 293 F.2d 78	16
Opper v. *Hancock Securities Corp.*, 367 F.2d 157, affirming, 250 F. Supp. 668	10
Petroleum Exploration, Inc. v. *Public Service Commission*, 304 U.S. 209	24
Rekant v. *Desser*, 425 F.2d 872	10-11
Ruckle v. *Roto American Corp.*, 339 F.2d 24	32
Sargent v. *Genesco, Inc.*, 492 F.2d 750	9
Securities and Exchange Commission v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180	13, 18
Securities and Exchange Commission v. *National Securities, Inc.*, 393 U.S. 453	23
Securities and Exchange Commission v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, certiorari denied *sub nom. Coates* v. *Securities and Exchange Commission*, 394 U.S. 976	11, 17, 28

Cases--Continued Page

Schoenbaum v. *Firstbrook*, 268 F. Supp. 385, affirmed, 405 F.2d 200, reversed in part on other grounds, 405 F.2d 215, certiorari denied *sub nom. Manley* v. *Schoenbaum*, 395 U.S. 906 12
Shapiro v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228 28
Sierra Club v. *Morton*, 405 U.S. 727 19
Simmons v. *Wolfson*, 428 F.2d 455, certiorari denied, 400 U.S. 999 ..... 9, 12
Slavin v. *Germantown Fire Ins. Co.*, 174 F.2d 799 18
Smallwood v. *Pearl Brewing Corp.*, 489 F.2d 579 9
Stockwell v. *Reynolds & Co.*, 252 F. Supp. 215 10
Superintendent of Insurance v. *Bankers Life & Casualty Co.*, 430 F.2d 355, reversed, 404 U.S. 6 ..... 6-7, 8, 10, 13, 15, 18, 19, 21, 31
Tcherepnin v. *Knight*, 389 U.S. 332 ..... 18, 24
Travis v. *Anthes Imperial Ltd.*, 473 F.2d 515 32
Tully v. *Mott Supermarkets, Inc.*, 337 F. Supp. 834 9
United States v. *Blue Chip Stamp Co.*, 272 F. Supp. 432 3
United States v. *Students Challenging Regulatory Agency Procedures*, 412 U.S. 669 19
Vine v. *Beneficial Finance Co.*, 374 F.2d 627, certiorari denied, 389 U.S. 970 ..... 21, 32
Wyandotte Transportation Co. v. *United States*, 389 U.S. 191 ..... 6, 19, 21

Cases—Continued Page

Young v. *Seaboard Corp.*, 360 F. Supp. 490 9

Statutes and rules:

Securities Act of 1933, 48 Stat. 74, as amended, 15 U.S.C. 77a, *et seq.*:

Section 17(a), 15 U.S.C. 77q(a) 12, 29

Securities Exchange Act, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*:

Section 10(b), 15 U.S.C. 78j(b) ..... *passim*
Section 14(a), 15 U.S.C. 78n(a) 22
Section 27, 15 U.S.C. 78aa 19

Rules under Securities Exchange Act of 1934:

Rule 10b-5, 17 C.F.R. 240.10b-5 ..... *passim*
Rule 10b-5(c), 17 C.F.R. 240.10b-5 (c) 10
Rule 14a-9(a), 17 C.F.R. 240.14a-9 (a) 22

Miscellaneous:

2 Bromberg, *Securities Law: Fraud—SEC Rule 10b-5*, Sec. 7.6(1), p. 190.21 (1973) 11
Comment, *Inroads on the Necessity for a Consummated Purchase or Sale under Rule 10b-5*, 1969 Duke L.J. 349 (1969) 23
Comment, *The Decline of the Purchaser-Seller Requirement of Rule 10b-5*, 14 Vill. L. Rev. 499 (1969) 23

Miscellaneous—Continued Page

Comment, *The Purchaser-Seller Rule: An Archaic Tool for Determining Standing under Rule 10b-5*, 56 Geo. L.J. 1177 (1968) 23
78 Cong. Rec. 7696 14
H. Rep. No. 1383, 73d Cong., 2d Sess. 11, 13
H. Conf. Rep. No. 1838, 73d Cong., 2d Sess. 14, 15
Hearings before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and 8720, 73d Cong., 2d Sess. 14, 15
Hearings before the Senate Committee on Banking and Currency on S. Res. 84 (72d Cong.) and S. Res. 56 and 97 (73d Cong.), Part 15, 73d Cong., 1st Sess. 15
Investors Management Co., Inc., Securities Exchange Act Release No. 9267 (July 29, 1971) 17
Jacobs, *Birnbaum in Flux: Significant 10b-5 Developments*, 2 Sec. Reg. L.J. 305 (1975) 23
Leech, *Transactions in Corporate Control*, 104 U. Pa. L. Rev. 725 (1956) 23
Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 Va. L. Rev. 268 (1968) 23
Merrill Lynch, Pierce, Fenner & Smith, Inc., Securities Exchange Act Release No. 8459 (November 25, 1968) 17
Note, *Civil Liability Under Rule X-10b-5*, 42 Va. L. Rev. 537 (1956) 24

Miscellaneous—Continued

Page

Note, *Fiduciary Suits Under Rule 10b-5*, 1968 Duke L.J. 791 23
Note, *Limiting the Plaintiff Class: Rule 10b-5 and the Federal Securities Code*, 72 Mich. L. Rev. 1398 (1974) 23
Note, *Rule 10b-5: Elements of a Private Right of Action*, 43 N.Y.U. L. Rev. 541 (1968) 23-24
Note, *Standing to Sue in 10b-5 Action: Eason* v. *GMAC and Its Impact on the Birnbaum Doctrine*, 49 Notre Dame Lawyer 1131 (1974) 23
Note, *The Purchaser-Seller Limitation to SEC Rule 10b-5*, 53 Cornell L. Rev. 684 (1968) 23
2 *Restatement of Torts*, Sec. 286 20
Ruder, *Current Developments in the Federal Law of Corporate Fiduciary Relations—Standing to Sue Under Rule 10b-5*, 26 Bus. Law 1289 (1971) 24
S. 3420, 73d Cong., 2d Sess. 15
S. Rep. No. 1455, 73d Cong., 2d Sess. 13, 14
27 Vand. L. Rev. 572 (1974) 23

In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-124

BLUE CHIP STAMPS, ET AL., PETITIONERS

v.

MANOR DRUG STORES, ETC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

QUESTION PRESENTED

The Commission will discuss the first question presented: Whether a party who neither purchased nor sold securities has standing to seek damages for injuries caused it by a violation of the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Commission is primarily responsible for the administration and enforcement of the federal securities laws, including the Securities Exchange Act of 1934. Private actions by the victims of securities frauds, however, are a "necessary supplement" to the Commission's enforcement activities. *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 382; *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432. The Commission opposes restrictive constructions of the securities laws and of the Commission's rules that would weaken the protections they afford investors. Accordingly, the Commission as *amicus curiae* in private actions has argued consistently that the right to recover damages for violations of the broad antifraud provisions of Rule 10b-5, authorized by Section 10(b) of the Securities Exchange Act, should not be limited to actual purchasers and sellers of securities but should extend to all investors and potential investors injured by violations of the Rule.

STATEMENT

In December 1963 the United States filed a civil antitrust action against Blue Chip Stamp Co. and nine of its twelve stockholders.[1] The complaint charged that the defendants had conspired to restrain and had

[1] This statement of facts is taken from the opinion of the court of appeals and from the complaint filed by Manor Drug Stores. Because the district court granted petitioners' motion to dismiss the complaint, its factual allegations must be accepted as correct. *Conley* v. *Gibson*, 355 U.S. 41.

monopolized the trading stamp business in California. In addition to Blue Chip Stamp Co., the defendants were major California retailers who used Blue Chip stamps and who collectively owned 90 percent of Blue Chip Stamp Co. stock. The suit was settled in 1967 by a consent judgment. See *United States* v. *Blue Chip Stamp Co.*, 272 F. Supp. 432 (C.D. Calif.).

The judgment provided that Blue Chip Stamp Co. would be merged into a new corporation, Blue Chip Stamps. Securities of the new corporation were to be offered, at "bargain" prices, to retail firms—including Manor Drug Stores, the plaintiff in this action—that had used Blue Chip stamps but had not owned stock in Blue Chip Stamp Co. Each of these retail firms was entitled to purchase securities in proportion to the amount of stamps it had used. The complaint of respondent Manor Drug Stores alleges that the securities were offered at a bargain in order to allow the users to share in the undistributed profits of Blue Chip Stamp Co. (App. 10-11).

The complaint charges that the defendants (now petitioners) devised a scheme to dissuade the offerees, by means of misleading statements, from purchasing the securities. The apparent motivation for the scheme was that any securities not purchased in the "bargain" offer could be sold later on the open market by petitioners at a greater price, thereby increasing the assets of Blue Chip Stamps and the value of each share owned by the other petitioners. Alternatively, the shares not sold in the offering could be retained by Blue Chip Stamps and the shareholders of

Blue Chip Stamps could "retain" the undistributed profits that would have been distributed by the "bargain" sale.[2]

In order to discourage the offerees from purchasing the securities, petitioners unduly emphasized in the prospectus (App. 55-90) certain "Items of Special Interest" that might adversely affect the value of the securities; the prospectus also contained inflated estimates of anticipated expenses. Because of these misleading representations certain offerees did not purchase the securities and, therefore, did not receive the intended "bargain."[3]

The district court dismissed the complaint on the basis of the "*Birnbaum* rule," attributed to *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (C.A. 2), certiorari denied, 343 U.S. 956, which states that a person who is neither a purchaser nor a seller of securities may not bring an action under Section 10 (b) of the Securities Exchange Act of 1934 or Rule 10b-5 thereunder.

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[2] As petitioners noted (Br. 7, n. 6), the plan of reorganization did not call specifically for public sale of the unsold shares. The plan, however, forbade petitioners from owning more than 43 percent of Blue Chip Stamps and, if some of the users decided not to purchase the shares offered, petitioners would have to sell either the unpurchased shares or their own shares in order to reduce their holdings to this proportion. In either event the asset value per share would be greater for petitioners if the users failed to purchase their allotments.

[3] Although the offering price of the new securities was $101, the market value was alleged to be $315 at that time (App. 11).

Respondents appealed, but before the appeal was decided another panel of the Ninth Circuit, in *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339, adopted the *Birnbaum* rule. A divided panel in the instant case accepted *Birnbaum* and *Mount Clemens* as controlling, but reversed on the ground that those cases did not involve a situation where the plaintiffs had a right to buy securities "at a fixed price and in a fixed amount" (App. 141). The court held that the offering of securities in this case, in compliance with the antitrust decree, "served the same function as" a contract for the purchase or sale of securities and therefore supported a damages remedy for the non-buying plaintiff class (App. 141, 155).

SUMMARY OF ARGUMENT

Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5, promulgated by the Securities and Exchange Commission pursuant to Section 10 (b), provide that it is unlawful to use deceptive devices or make misleading statements "in connection with the purchase or sale of any security." In *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (C.A. 2), certiorari denied, 343 U.S. 956, the Second Circuit held that under the Act and Rule only individuals who had purchased or sold securities could bring actions to seek redress for a violation.

The proscriptions under Section 10(b) and Rule 10b-5 "are broad and, * * * are obviously meant to be inclusive." *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151. Accordingly, a violation of Section 10(b) and Rule 10b-5 repeatedly has been held not to depend upon proof of an actual purchase or sale of a security, and includes deceptive activity that affects an investment decision not to buy or sell a security no less than a decision to do the contrary. Even the dissenting opinion in the court below does not question that a violation of Rule 10b-5 has been alleged in this case.

The *Birnbaum* rule has nevertheless survived as an essentially arbitrary principle of "standing"—that a victim of a violation may bring an action for damages only if he is the purchaser or seller of securities —although the courts applying the rule disagree as to its precise scope and as to exceptions that may be available. The *Birnbaum* limitation is inconsistent with this Court's repeated recognition that persons within the class a statute is designed to protect, and who have been injured by a violation of that statute, have standing to seek relief for injuries they have suffered. See, *e.g.*, *Wyandotte Transportation Co.* v. *United States*, 389 U.S. 191. This principle has been applied generally under the Securities Exchange Act, see *J. I. Case Co.* v. *Borak*, 377 U.S. 426, and *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, and specifically under Rule 10b-5, *Superintendent of Insurance* v.

Bankers Life & Casualty Co., 404 U.S. 6, and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128.

Consistent with this principle, courts of appeals that have applied the *Birnbaum* doctrine to damage actions have nevertheless permitted private suits for equitable relief with respect to violations of Rule 10b-5. But as this Court recognized in *Borak*, *supra*, and *Mills*, *supra*, with respect to similar antifraud rules relating to proxy solicitation, the remedial objectives of the Securities Exchange Act require that a private action for damages also be recognized.

To the extent the *Birnbaum* rule serves any purpose, it acts as a device to limit the class of potential plaintiffs, and thus, as petitioners point out, may ameliorate the possibility of strike suits and "calamitous" damage judgments. But the arbitrary denial of standing to individuals who are not purchasers or sellers of securities but have suffered demonstrable loss because of a violation of the Act is contrary to the purposes of the securities laws and unjustified. The public policy of preventing unwarranted damage awards could be achieved through requirements (in appropriate cases) of stricter standards of proof or the limitation of vicarious liability.

ARGUMENT

THE VICTIM OF DECEPTIVE ACTIVITIES IN CONNECTION WITH THE PURCHASE OR SALE OF SECURITIES SHOULD BE ABLE TO RECOVER HIS DEMONSTRABLE DAMAGES WHETHER OR NOT HE HAS PURCHASED OR SOLD SECURITIES

In *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (C.A. 2), certiorari denied, 343 U.S. 956, the Second Circuit discussed the understanding it then had of the purpose of Section 10(b) and Rule 10b-5. It stated that the Rule is directed "only at 'a fraud perpetrated upon the purchaser or seller' of securities," *id.* at 463, and that, accordingly, the Rule "extended protection only to the defrauded purchaser or seller."[4] *Id.* at 464. This narrow reading of Rule

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[4] The plaintiff in *Birnbaum* was a shareholder in a corporation contemplating an advantageous merger with another firm. The controlling shareholder in the corporation in which plaintiff held securities elected to sell his shares, at a substantial control premium, to a third corporation. As a result of this sale of control the possibilities for merger were foregone, and plaintiff did not reap the advantages that merger would have brought him. He sued the controlling shareholder and the acquiring corporation; the court of appeals affirmed a dismissal of the action, stating that the Rule was not intended to protect the stockholders of a corporation against a breach of fiduciary duties by corporate insiders. *Id.* at 464. If no more were involved in *Birnbaum*, the case would not be troublesome. This Court has subsequently agreed that the statute does not regulate transactions that constitute no more than internal corporate mismanagement. *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12.

10b-5—principally based on the court's narrow reading of Section 10(b)—has not been followed.

The "*Birnbaum* rule" has become a principle of "standing," rather than an interpretation directed to any limitation on the scope of the Act's and Rule's prohibitions—that is, despite allegations of a clear violation of Section 10(b) and Rule 10b-5 that have resulted in injury, if the injured person did not purchase or sell the securities he may not bring an action to recover his damages.[5]

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[5] Most courts of appeals have accepted the *Birnbaum* rule, although the courts disagree about the scope of the doctrine and the exceptions available to avoid its application. See, *e.g.*, *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963 (C.A. 2), certiorari denied, 398 U.S. 909; *Landy* v. *Federal Deposit Insurance Corp.*, 486 F.2d 139 (C.A. 3), certiorari denied, 416 U.S. 960; *Sargent* v. *Genesco, Inc.*, 492 F.2d 750 (C.A. 5); *Smallwood* v. *Pearl Brewing Corp.*, 489 F.2d 579 (C.A. 5); *City National Bank* v. *Vanderboom*, 422 F.2d 221 (C.A. 8), certiorari denied, 399 U.S. 905; *Simmons* v. *Wolfson*, 428 F.2d 455 (C.A. 6), certiorari denied, 400 U.S. 999; *cf. Kerbs* v. *Fall River Industries, Inc.*, 502 F.2d 731, 738-740 (C.A. 10); *International Controls Corp.* v. *Vesco*, 490 F.2d 1334 (C.A. 2), certiorari denied, 417 U.S. 932; *Hooper* v. *Mountain States Securities Corp.*, 282 F.2d 195 (C.A. 5), certiorari denied, 365 U.S. 814; *James* v. *Gerber Products Co.*, 483 F.2d 944 (C.A. 6).

The Seventh Circuit has rejected *Birnbaum*. See *Eason* v. *General Motors Acceptance Corp.*, 490 F.2d 654, certiorari denied, 416 U.S. 960. Several district courts recently have disavowed the *Birnbaum* rule as inconsistent with the prevailing interpretation of Rule 10b-5. See *Young* v. *Seaboard Corp.*, 360 F. Supp. 490 (D. Utah); *Tully* v. *Mott Supermarkets, Inc.*, 337 F. Supp. 834 (D.N.J.). (*Landy* v. *Federal Deposit Insurance Corp.*, *supra*, 486 F.2d at 156, n. 10, apparently limits *Tully* to requests for injunctive relief.) And several district courts have held that there may be a private

A. Section 10(b) and Rule 10b-5 Protect "Any Person" Against Deceptive Devices Material To An Investment Decision

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), provides that it is unlawful for any person to use, "in connection with the purchase or sale of any security * * * any manipulative or deceptive device or contrivance" in contravention of the Commission's rules. In *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151, this Court stated that Rule 10b-5(c) prohibits "any act, practice or course of business which operates or would operate as a fraud or deceit upon any person * * *," and held that the proscriptions under Section 10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive." Similarly, *Superintendent of Insurance*, *supra*, 404 U.S. at 11, n. 7, held that Section "10(b) and Rule 10b-5 prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, * * *."[6] As the court below recognized prior to the instant case:[7]

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action by an investor who, in violation of the rule, has been misled not to sell his securities. See, *e.g.*, *Commerce Reporting Co.* v. *Puretec, Inc.*, 290 F. Supp. 715, 718-719 (S.D. N.Y.); *Opper* v. *Hancock Securities Corp.*, 367 F.2d 157 (C.A. 2), affirming 250 F. Supp. 668 (S.D.N.Y.); *Goodman* v. *H. Hentz & Co.*, 265 F. Supp. 440, 443-445 (N.D. Ill.); *Stockwell* v. *Reynolds & Co.*, 252 F. Supp. 215, 213-219 (S.D.N.Y.); *M. L. Lee & Co.* v. *American Cardboard & Packaging Corp.*, 36 F.R.D. 27, 30-31 (E.D. Pa.).

[6] Emphasis in original. This Court was quoting from *A. T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 397 (C.A. 2).

[7] *Ellis* v. *Carter*, 291 F.2d 270, 274 (C.A. 9), dismissal affirmed, 328 F.2d 573. Accord, *Rekant* v. *Desser*, 425 F.2d

> It would have been difficult to frame the authority to prescribe regulations in broader terms. * * * We see no reason to go beyond the plain meaning of the word "any", indicating that the use of manipulative or deceptive devices or contrivances of whatever kind may be forbidden * * *.

Even the court of appeals that decided *Birnbaum* has subsequently stated that the broad language of Rule 10b-5 "demonstrates that the SEC sought by the Rule * * * fully to implement the Congressional purpose and objectives underlying Section 10(b)."[8] And, as one commentator wrote, the Section and Rule contain what is "plainly and—one must assume—intentionally the loosest linkage, in any of the federal antifraud provisions, between a proscribed act and a security transaction."[9]

Petitioners assert (Pet. Br. 31) that the language of Rule 10b-5 and Section 10(b), by "limiting" their coverage to matters "in connection with the purchase

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872, 880 n.15 (C.A. 5); see also *McClure* v. *Borne Chemical Co.*, 292 F.2d 824, 834 (C.A. 3), certiorari denied, 368 U.S. 939.

[8] *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 860 (C.A. 2) (*en banc*), certiorari denied *sub nom. Coates* v. *Securities and Exchange Commission*, 394 U.S. 976.

The House Committee appraised the function of the Securities Exchange Act as an undertaking to advance the law by a "constant extension of the legal conception of a fiduciary relationship—a guarantee of 'straight shooting' * * *." H. Rep. No. 1383, 73d Cong., 2d Sess. 5.

[9] Bromberg, *Securities Law: Fraud—SEC Rule 10b-5*, Sec. 7.6(1), p. 190.21 (1973).

or sale of any security," "does not include an *offer* to purchase or sell" (petitioners' emphasis). They conclude: "Had Congress intended section 10(b) to reach offers, it knew how to accomplish that purpose." But Section 17(a) of the Securities Act, upon which the language of Rule 10b-5 is based, expressly and unambiguously proscribes fraud "in the offer" as well as fraud "in the * * * sale of any securities * * *." As the petitioners themselves recognize (Pet. Br. 18-19), Rule 10b-5 was adopted to extend to "all purchasers of securities" the same "prohibitions on fraud" that Section 17(a) imposed upon sellers.[10] Although Section 17(a) of the Securities Act relates only to

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[10] Even if Rule 10b-5 were limited in application as the petitioners suggest, the plaintiff's only error in the district court was in failing to allege a cause of action predicated upon Section 17(a) of the Securities Act as well as one under Rule 10b-5.

The complaint must be read in the light most favorable to the plaintiff, recognizing that any ambiguities or omissions in the pleadings should be resolved in favor of the plaintiff, since any such deficiencies in the complaint can be cured by amendment, see *Lanasa Fruit S. S. & I. Co.* v. *Universal Insurance Co.*, 302 U.S. 556, 559. For the same reasons that a cause of action is recognized under Rule 10b-5, it must be recognized under Section 17(a). This would cure the deficiency that the petitioners perceive—although some courts, disregarding even the unambiguous expression of congressional purpose, have applied the *Birnbaum* doctrine to actions brought under Section 17(a) as well as under Rule 10b-5. See, *e.g.*, *Schoenbaum* v. *Firstbrook*, 268 F. Supp. 385, 396 (S.D. N.Y.), affirmed, 405 F.2d 200 (C.A. 2), reversed in part on other grounds, 405 F.2d 215 (*en banc*), certiorari denied *sub nom. Manley* v. *Schoenbaum*, 395 U.S. 906; *Greater Iowa Corp.* v. *McLendon*, 378 F.2d 783, 790-791 (C.A. 8); *Simmons* v. *Wolfson*, *supra*, 428 F.2d 455.

fraudulent activity "in" the offer or sale of securities, the broader statutory language "in connection with" used in Section 10(b) and Rule 10b-5 (which relates to all deceptive activities "touching" securities transactions, *Superintendent of Insurance, supra*, 404 U.S. at 12) made it unnecessary to include the word "offer" in those provisions. Cf. *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 197-199.

There can be no doubt under the Act, Rule, and controlling decisions of this Court, that, if the allegations of respondent's complaint are true, prohibited deceptive statements have been made. This conclusion is supported by the legislative history of the statute. The Securities Exchange Act of 1934 was enacted in response to "the speculative orgy of 1928 and 1929" [11] and a presidental call for securities "legislation [that] has teeth in it." [12] Congress, recognized that "[s]peculation, manipulation, * * * investors' ignorance, and disregard of trust relationships by those whom the law should regard as fiduciaries" were "all a single seamless web," [13] and that an act designed to purge all avenues of abuse would require broad remedial provisions. Thus, the Act was intended to cover "a wide field." [14]

Congress understood, however, that it could not, by specifying or cataloguing particular forms of unlaw-

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[11] S. Rep. No. 1455, 73d Cong., 2d Sess. 81.

[12] H. Rep. No. 1383, 73d Cong., 2d Sess. 2.

[13] H. Rep. No. 1383, 73d Cong., 2d Sess. 6.

[14] *Ibid.*

ful conduct, itself effectively prohibit all forms of practices that "for some purposes may be turned to illegitimate and fraudulent means." [15] Accordingly, it vested "broad discretionary powers in the [Securities and Exchange Commission]." [16] See generally *Superintendent of Insurance, supra.*

Section 10(b) creates such discretionary power by authorizing the Commission by rule and regulation to proscribe manipulative or deceptive practices in connection with the purchase or sale of any security. As one of the draftmen described an earlier version (then Section 9(c)) before the House Committee, the section provided, in effect:

> "Thou shalt not devise any other cunning devices." * * * [S]ubsection (c) is a catch-all clause to prevent manipulative devices. * * * The Commission should have the authority to deal with new manipulative devices.[17]

The Senate bill, from which most of Section 10(b) was taken verbatim,[18] went further; it gave the Commission broad rulemaking authority with respect to deceptive as well as manipulative practices. Although

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[15] *Id.* at 7.

[16] *Ibid.*; see also 78 Cong. Rec. 7696 (remarks of Rep. Rayburn). The Senate Committee viewed the Securities Act of 1933 and the Securities Exchange Act of 1934 as vesting "in the Securities and Exchange Commission jurisdiction over the source of and traffic in securities." S. Rep. No. 1455, 73d Cong., 2d Sess. 393.

[17] Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and 8720, 73d Cong., 2d Sess. 115.

[18] H. Conf. Rep. No. 1838, 73d Cong., 2d Sess. 32-33.

representatives of the securities industry had complained that these provisions would give the Commission power to prohibit virtually anything,[19] the Conference Committee broadened the language of the section still further.

The Senate bill would have authorized rulemaking with respect to practices "detrimental to the interests of the investor," but the Committee expanded the authority to cover rulemaking "necessary or appropriate in the public interest" as well as "for the protection of investors." [20] After considering these alternatives, Congress agreed upon the present language, which gives the Commission broad rulemaking power to prohibit "any manipulative or deceptive device or contrivance," and omitted language that would have confined the section solely to securities traded or listed on a national securities exchange.[21]

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[19] Hearings on H.R. 7852 and 8720, *supra*, n. 17, at 178, 208-209, 251, 258, 297, 305, 486; Hearings Before the Senate Committee on Banking and Currency on S. Res. 84 (72d Cong.) and S. Res. 56 and 97 (73d Cong.), Part 15, 73d Cong., 1st Sess. 6624-6625, 6634, 6899, 6910, 6936-6938, 6988.

[20] H. Conf. Rep. No. 1838, *supra*, at 32-33. Cf. *A.T. Brod & Co.* v. *Perlow*, *supra*, 375 F.2d at 396:

> These rules and regulations [under Section 10(b)] were to be promulgated by the Commission *"in the public interest or* for the protection of investors." * * * Rule 10b-5 * * * was designed to protect both investors *and* 'the public interest.' [Emphasis in original.]

[21] See S. 3420, Section 10(b), 73d Cong., 2d Sess. (April 17, 1934). In enacting Section 10(b), Congress intended to ensure fairness in securities transactions generally, whether conducted in the organized securities markets or face-to-face. *Superintendent of Insurance*, *supra*, 404 U.S. at 10.

In order to fulfill these Congressional objectives, the courts have repeatedly rejected restrictive readings of Rule 10b-5. For example, proof of a substantive violation of Section 10(b) and Rule 10b-5 does not depend upon proof of an actual purchase or sale of a security. In *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 854-855 (C.A. 2), certiorari denied *sub nom. Coates* v. *Securities and Exchange Commission*, 394 U.S. 976, the court held that deceptive public statements, negligently made, that might generally affect securities transactions, violate Rule 10b-5. Nor must the Commission, in its own actions, demonstrate that any persons have suffered injury because of a purchase or sale; it need show only that the forbidden deceptive practices have been committed. *Hughes* v. *Securities and Exchange Commission*, 174 F.2d 969, 974 (C.A.D.C.). See also *Berko* v. *Securities and Exchange Commission*, 316 F.2d 137, 143 (C.A. 2); *N. Sims Organ & Co., Inc.* v. *Securities and Exchange Commission*, 293 F.2d 78, 80, n. 3 (C.A. 2). Cf. *Kuehnert* v. *Texstar Corp.*, 412 F.2d 700, 704 (C.A. 5), in which the court stated that it was not convinced that there was any difference in substance between a successful fraud and an attempt, since the statutory phrase " 'any manipulative or deceptive device' * * * seem[ed] broad enough to encompass conduct irrespective of its outcome."

The Court of Appeals for the Second Circuit has aptly noted that material facts that must be fully disclosed if the standard of Rule 10b-5 is to be met include those "which may affect the desire of investors to buy, sell, or hold the company's securities." *Securi-*

ties and Exchange Commission v. *Texas Gulf Sulphur Co.*, *supra*, 401 F.2d at 849. Consistent with this view is *Hanly* v. *Securities and Exchange Commission*, 415 F.2d 589, 594-595 (C.A. 2), which applied Rule 10b-5 to misleading statements and omissions that had induced a broker's customer to hold his stock rather than to sell it in the face of a declining market. In administrative proceedings the Commission has repeatedly taken the position that a person violates the Rule by misleading an investor not to sell.[22]

Because—if the assertions in respondent's complaint are correct—there has been a violation by petitioners of the Act and Rule, the question open for decision is whether that violation can be redressed by a private plaintiff.

B. There Is an Implied Civil Remedy on Behalf of All Persons Injured by Violations of Rule 10b-5, Including Those Who Have Neither Purchased Nor Sold Securities

The limitation on standing imposed by the *Birnbaum* rule is inconsistent with the decisions of this and other courts that have implied causes of action for violations of the securities acts' prohibitions in order to provide redress to persons for whose protection those prohibitions were adopted.

Although Section 10(b) and Rule 10b-5 do not expressly provide a civil remedy to the victims of proscribed behavior, this Court has recognized an implied

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[22] See, *e.g.*, *Investors Management Co., Inc.*, Securities Exchange Act Release No. 9267 (July 29, 1971), pp. 9-10; *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Securities Exchange Act Release No. 8459 (November 25, 1968), p. 5.

right of action under their provisions. *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*, 404 U.S. at 13 n.9; *Affiliated Ute Citizens* v. *United States*, *supra*, 406 U.S. at 151.[23] These two decisions reflect this Court's repeated admonition that the federal securities laws, "enacted for the purpose of avoiding frauds," must be construed "not technically and respectively, but flexibly to effectuate [their] remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (Investment Advisers Act). In *Tcherepnin* v. *Knight*, 389 U.S. 332, 336, this principle was applied to the Securities Exchange Act generally; and in *Superintendent*, *supra*, 404 U.S. at 12, and *Affiliated Ute Citizens*, *supra*, 406 U.S. at 151, this Court recognized that damages could be sought for violations of Section 10(b) and Rule 10b-5.

A private right of action under Rule 10b-5 reflects this Court's recognition that "[p]rivate enforcement * * * provides a necessary supplement to Commission action." *J.I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 432. Accordingly, this Court in *Borak* directed "the federal courts 'to adjust their remedies so as to grant the necessary relief' where federally secured rights are invaded." *Id.* at 433. It continued:

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[23] The Courts of Appeals have long recognized an implied right of action under Rule 10b-5. See, *e.g.*, *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (C.A. 2); *Fratt* v. *Robinson*, 203 F.2d 627 (C.A. 9); *Hooper* v. *Mountain States Securities Corp.*, 282 F.2d 195; cf. *Slavin* v. *Germantown Fire Insurance Co.*, 174 F.2d 799, 805-806 (C.A. 3) (*dictum*).

> And it is also well settled that where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done.

It then held that Section 27 of the Securities Exchange Act provided such a "general right to sue" because it "grants the District Courts jurisdiction 'of all suits in equity and actions at law brought to enforce any liability or duty created by this title.'" *Ibid.*

Borak and this Court's more recent cases apply to the Securities Exchange Act the principle, applied in other areas of the law, that the touchstone for determining whether particular persons may maintain a civil action to redress a violation of a statutory prohibition or obligation is whether their interest "fell within the class that the statute was intended to protect" and whether "the harm that had occurred was of the type that the statute was intended to forestall." *Wyandotte Transportation Co.* v. *United States*, 389 U.S. 191, 202.[24]

This was the principle recognized and applied in *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa.), the first judicial decision holding that there is an implied right of action under Rule 10b-5. There the plaintiff's standing to seek relief was upheld because the plaintiff was within the class of persons

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[24] See also *United States* v. *Students Challenging Regulatory Agency Procedures*, 412 U.S. 669, 686; *Sierra Club* v. *Morton*, 405 U.S 727, 733; *Association of Data Processing Organizations, Inc.* v. *Camp*, 397 U.S. 150, 152-153. Cf. *Flast* v. *Cohen*, 392 U.S. 83; *Hardin* v. *Kentucky Utilities Co.*, 390 U.S. 1.

"for whose special benefit the statute was enacted." [25]

More recently, the Court of Appeals for the Seventh Circuit in *Eason* v. *General Motors Acceptance Corp.*, 490 F.2d 654, certiorari denied, 416 U.S. 960, correctly perceived that the opinions of this Court "fairly imply that the rule [10b-5] was intended to protect a broader class of persons" than only purchasers and sellers of securities. 490 F.2d at 659. Because the plaintiffs in that case "were members of the class for whose special benefit Rule 10b-5 was adopted," *id.* at 658, they were held to have standing to seek damages for their alleged injuries, although they were neither purchasers nor sellers of securities.

A primary purpose of Rule 10b-5 is to protect *all* persons, not merely persons who may have purchased or sold securities, against making investment decisions on the basis of misleading or inaccurate information. In prohibiting misleading or deceptive practices that operate as a fraud upon "any person," it prohibits such practices where their tendency is improperly to discourage action no less than when their

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[25] *Kardon* based its decision on 2 Restatement of Torts, Sec. 286, which provided:

> The violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if: (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) *the interest invaded is one which the enactment is intended to protect* * * * [emphasis added].

See also *Fratt* v. *Robinson*, *supra*, 203 F.2d at 631; *Fischman* v. *Raytheon Mfg. Co.*, *supra*, 188 F.2d at 787, n. 4; *Hooper* v. *Mountain States Securities Corp.*, *supra*, 282 F.2d at 201.

tendency is to encourage unwarranted action. Indeed, in *Superintendent of Insurance, supra,* 404 U.S. at 12, the Court observed that among those Congress sought to protect from the impact of fraud were persons who were the creditors of corporations that may have been misled into buying or selling securities.[26] *A fortiori*, persons making investment decisions, including the decision not to purchase or sell, are within the scope of the Act, and should (under the *Borak* and *Wyandotte* principle) be able to recover damages.

Consistently with the principles supporting a private cause of action, the courts generally have recognized that a person who has neither purchased nor sold securities nevertheless is entitled to the protection of Rule 10b-5, and therefore can obtain equitable relief with respect to an alleged Rule 10b-5 violation. *Kahan* v. *Rosenstiel*, 424 F. 2d 161 (C.A. 3), certiorari denied *sub nom. Glen Alden Corp.* v. *Kahan*, 398 U.S. 950; *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F. 2d 540, 546-547 (C.A. 2); *Britt* v. *Cyril Bath Co.*, 417 F. 2d 433 (C.A. 6). In light of these decisions, some of which have been rendered by the same courts that adhere to the *Birnbaum* rule, it is

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[26] Situations where individuals are injured by the investment decisions of others include that involved in *Vine* v. *Beneficial Finance Co.*, 374 F.2d 627 (C.A. 2), certiorari denied, 389 U.S. 970, in which so many of plaintiff's fellow shareholders accepted a tender offer (which was misleading, in violation of Rule 10b-5) that the acquiring corporation was able to effect a merger, causing plaintiff injury. The *Vine* court permitted recovery, and reconciled its holding with the *Birnbaum* doctrine by deeming the merger to be a "forced sale" of the plaintiff's securities.

significant that in *Borak* this Court expressly rejected a contention that the private right of action for violation of the antifraud provisions of proxy Rule 14a-9(a)[27] should be "limited to prospective relief," and held that the remedial objectives of the Securities Exchange Act required that a private right of action for damages also be recognized.[28]

The Court observed in *Borak* that to limit "victims of deceptive proxy statements" to prospective relief under the federal statute would relegate them to state court monetary remedies, and if these proved inadequate, "the whole purpose of the section [14(a)] might be frustrated." 377 U.S. at 434-435. Moreover, building upon these principles, *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, rejected an interpretation that would have "[insulated] from private redress an entire category of proxy violations * * *," holding that "such a result would subvert the congressional purpose of ensuring full and fair disclosure to shareholders." 396 U.S. at 382.

The same reasoning applies to the scope of Rule 10b-5 and the remedies available under it. "[T]here

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[27] The language of Rule 14a-9(a) is substantially similar to the language of Rule 10b-5(b).

[28] Based upon the "purpose of § 14(a) * * * to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation," 377 U.S. at 431, and the language of Section 14(a), which, like Section 10(b), authorizes the adoption of rules "in the public interest *or for the protection of investors*," 377 U.S. at 432 (emphasis by the Court), the Court recognized "the availability of judicial relief where necessary to achieve that result." 377 U.S. at 432.

is no reason to emasculate the securities laws by forbidding remedies which might prove to be essential. Cf. *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964)." *Securities and Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 463. If the rule is to be effective in accomplishing its objective of preventing fraud relating to securities transactions, the right of the victims of such fraud to maintain a private suit based upon their negative actions must encompass damages as well as injunctive relief.[29] As the Court

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[29] Commentators have concluded that the *Birnbaum* decision was not dictated by the express language of Section 10(b) or Rule 10b-5. They also note that *Birnbaum* has encouraged mechanical application of a purchaser-seller requirement, producing results contrary to the purposes for which that legislation was enacted—to protect the public from the effects of fraudulent representations about securities. See, *e.g.*, Note, *Limiting the Plaintiff Class: Rule 10b-5 and the Federal Securities Code*, 72 Mich. L. Rev. 1398, 1412 (1974); Note, *Standing to Sue in 10b-5 Actions: Eason* v. *GMAC and Its Impact on the Birnbaum Doctrine*, 49 Notre Dame Lawyer 1131, 1146-1147 (1974); Comment, *Inroads on the Necessity for a Consummated Purchase or Sale under Rule 10b-5*, 1969 Duke L.J. 349 (1969); Comment, *The Purchaser-Seller Rule: An Archaic Tool for Determining Standing under Rule 10b-5*, 56 Geo. L.J. 1177, 1178 (1968); Note, *The Purchaser-Seller Limitation to SEC Rule 10b-5*, 53 Cornell L. Rev. 684, 698 (1968); Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 Va. L. Rev. 268, 275-276 (1968); see also, Jacobs, *Birnbaum in Flux: Significant 10b-5 Developments*, 2 Sec. Reg. L.J. 305 (1975); 27 Vand. L. Rev. 572 (1974); Leech, *Transactions in Corporate Control*, 104 U. Pa. L. Rev. 725, 774 (1956); Comment, *The Decline of the Purchaser-Seller Requirement of Rule 10b-5*, 14 Vill. L. Rev. 499, 501-502 (1969); Note, *Fiduciary Suits Under Rule 10b-5*, 1968 Duke L.J. 791, 807-808; Note, *Rule 10b-5: Elements of a Private Right of Action*, 43 N.Y.U. L. Rev. 541,

of Appeals for the Seventh Circuit observed in *Eason*, *supra*, 490 F.2d at 659, the purchaser-seller limitation

> is not consistent with the overriding requirement that, in construing the 1934 Act, "form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin* v. *Knight*, 389 U.S. 332, 336.

C. This Court Should Not Adopt the *Birnbaum* Rule as a Method to Limit the Class of Potential Plaintiffs

Petitioners express concern (Pet. Br. 34) that the decision of the court of appeals would allow anyone who had not purchased securities which were offered to him to bring an action simply by claiming that he would have purchased the securities, if the offeror had disclosed additional facts from which he might have inferred that the securities were worth more than the offering price.[30] We agree with petitioners that the effect, if any, of a deceptive prac-

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545 (1968); Note, *Civil Liability Under Rule X-10b-5*, 42 Va. L. Rev. 537, 570-571 (1956); Ruder, *Current Developments In The Federal Law of Corporate Fiduciary Relations —Standing to Sue Under Rule 10b-5*, 26 Bus. Law. 1289 (1971).

[30] Of course, frivolous suits can be brought whatever the rules of standing; it is necessary only for a determined plaintiff to plead words consistent with applicable standing requirements, even though he knows that he cannot succeed on the merits. Opportunities for vexatious litigation will abound whether or not the *Birnbaum* rule is adopted. As this Court has recognized in a different context, "the expense and annoyance of litigation is 'part of the social burden of living under government'." *Petroleum Exploration, Inc.* v. *Public Service Commission*, 304 U.S. 209, 222.

tice on someone who has neither purchased nor sold securities may be more difficult to demonstrate than is the effect on a purchaser or seller. In either case the plaintiff must demonstrate some relationship between the alleged deceptive practice and his injury. If, as here, that injury resulted from his own "non-action," he also must demonstrate that his failure to act was caused by the defendant's activities. But this additional problem of proof can be ameliorated by devices more consistent with the purposes of the securities laws.

In *Affiliated Ute Citizens, supra,* Indians sought relief under Rule 10b-5 against bankers who sought their shares in the course of encouraging a market for shares among non-Indians. This Court held that if there was a direct relationship between the Indians and the bankers, and the bankers omitted to state facts that a reasonable investor might have considered important in the making of his investment decision, a causal connection between the wrongful omission and the plaintiffs' injuries would be presumed. This presumption might apply in many cases involving potential investors. In other cases, however, it might be unreasonable for the courts to make such a presumption and, indeed, where only a tenuous relationship exists, it might be appropriate (in order to prevent abuses) to impose upon the plaintiffs a heavier burden of proof than would normally be applicable. It might be necessary, for example, for a plaintiff who has neither purchased nor

sold securities to offer corroborative evidence which, independent of his own testimony, tends to show that the plaintiff's investment decision was directly affected by the deceptive device (or that the violation caused him injury in some other way) and that he was within the class of persons for whose benefit the rule was adopted.[31]

Thus, contrary to petitioners' argument, a decision by this Court not to adopt the *Birnbaum* rule would not require submitting to the finders of fact every suit in which someone claimed that "but for" a public statement by the defendant the plaintiff would have acquired or would have sold securities. In fact, there would be few situations where plaintiffs could demonstrate a nexus between a wrongful act and an alleged injury sufficient to permit submission of the case to the jury, if that plaintiff were not the owner of securities or a person to whom an offer to buy or sell had been directed.

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[31] In the instant case, the direct relationship that is alleged to have existed between the plaintiff and the defendants seems sufficient to warrant the presumption permitted by *Affiliated Ute Citizens*. In any event, respondent's reliance upon the defendants' alleged deceptive practices is corroborated by the consent judgment in the antitrust action and by respondent's receipt of the misleading prospectus. It is reasonable to believe that respondent was actively considering a purchase of Blue Chip Stamps' securities, and that the representations in the prospectus were material to this decision. That should be sufficient objective indicia, particularly if a plaintiff can show, as respondent alleged here, that there was a plausible reason why the issuer of the shares would be motivated to make representations that would deter the plaintiff from acting.

Moreover, even where a proper nexus has been established, the fact that liability may be imposed upon individual wrongdoers does not require that a damage remedy must necessarily be recognized to the same extent against the corporations for which they work, if broad vicarious liability would conflict with the objectives of the federal securities laws. Although there are strong public policies that militate in favor of imposing liability upon a corporation for the acts of its officers and authorized agents, a court may well be concerned that the wrongful acts of officers in violations of Rule 10b-5 not expose the shareholders of a publicly-owned corporation to undue liability. Of course no reason exists, either in equity or in the objectives of the federal securities laws, to permit a corporation to retain profits or any other forms of benefits it may have derived from the wrongful acts of its officers or agents.[32] But where the corporation has not benefited, the courts may find it equitable, and consistent with the basis upon which

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[32] Since the *Birnbaum* rule may, in some situations, protect corporations from liability even to the extent of profits that can be traced to violations of the law, its rejection may impose additional costs on some companies. Judge Hufstedler's analysis in dissent below seems implicitly to assume that there is or may be widespread non-compliance with Rule 10b-5. If this is so, any increased costs that would result from allowing suit are the costs of compliance with the Rule, and long since should have been paid. The securities laws as a whole reflect a congressional judgment that the benefits to be derived from full disclosure of material facts outweigh the economic costs that disclosure entails.

a right of action has been implied under Rule 10b-5, to limit an award of damages against it.[33]

Nor is the arbitrary rule of "standing" advanced by petitioners essential to protect the "common method of distributing new securities * * *" (Pet. Br. 28). The case at bar is not the "typical securities transaction" described by petitioners (Pet. Br. 28-30); typically the issuer and underwriter seek to sell the securities as promptly as possible, and rarely if ever would make them appear unattractive through inadvertence or otherwise.

The *Birnbaum* rule does not produce a conflict between the registration requirements of the Securities Act and the antifraud provisions of the Securities Exchange Act, as petitioners suggest (Pet. Br. 36-42). To be sure, compliance with the registration requirements of the Securities Act assumes that proper emphasis be given to risk factors by persons who seek to sell securities to the public. In this context there may be a tendency to overstate risks, because it is doubtful that any court would find it appropriate to impose liability upon an offerer who tends somewhat to understate the merits of the securities he is honestly trying to sell, so long as no truly material falsehood or omission is involved.[34]

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[33] Cf. *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 241 (C.A. 2).

[34] The concept of materiality (see, *e.g.*, *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (C.A. 2) (*en banc*), certiorari denied, 394 U.S. 976) eliminates the possibility that the most minute mistake will lead to liability. Thus, offerers are not required to be "micro-

But where, as is alleged here, the sale of stock was contrary to the petitioners' self-interest, any overstatement of the risks should not be viewed charitably. Fraud in the offer of securities is a violation of Section 17(a) of the Securities Act, as well as a violation of Rule 10b-5 under the Securities Exchange Act, and, as we have seen (pp. 8-17, *supra*), the *Birnbaum* rule adds nothing to a registrant's substantive legal duty. It relates only to a plaintiff's ability to recover for injuries.[35]

Petitioners also argue (Pet. Br. 34-35) that the availability of the class-action procedure, a device designed to permit vindication of just claims that might be too small to pursue individually, and this Court's recognition that a causal relationship between wrongful acts and resultant injury may be inferred from the materiality of undisclosed facts, are reasons to deny standing. But this really is a complaint that remedies for violation of the Rule will work too well.

Throughout their brief (particularly at pp. 32-33) petitioners also stress that respondent was not an

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metrically accurate," as Judge Hufstedler seems to fear (App. 151, n. 8.).

[35] Thus, the alleged conflict is irrelevant to the question of standing, since petitioners' argument goes to the merits of plaintiff's claim that Rule 10b-5 has been violated, rather than to the threshhold question of who may bring suit to test those merits. If the petitioners can show that their discouraging statements concerning Blue Chips Stamps' prospects were justified, consistent with the conservative philosophy of the Securities Act registration requirements, they may prevail on the merits. But the possibility that they may have a good defense is no reason to deny a plaintiff its day in court.

"investor." [36] We submit that this is irrelevant. The essence of respondent's complaint is that petitioners fraudulently induced the offerees to refrain from investing; it would be most anomalous if the defendants' success in preventing an investment—the very fraud that gives rise to the claim for relief—should be viewed as a reason why the alleged victims should not even be heard on the merits of their claim.

Finally, petitioners suggest that it would be unfair to those who have invested in particular securities were a court to permit "those who have never invested in, or made a legal commitment to the offered securities," to "seek the profit they allegedly could have made had they accepted the offer, entered into the transaction and put their funds at risk" and then be "paid out of the pocket of the company with which those who bought risked their funds." (Pet. Br. 32-33). But this analysis, whatever its merits, does not support the *Birnbaum* rule.

Comparable situations exist even where the *Birnbaum* rule permits suit. For example, a similar no-risk-therefore-no-suit argument can be made where a person has been fraudulently induced to sell (thus ending his "risk") while other non-selling investors continued to risk their capital. The *Birnbaum* rule would not preclude these sellers, in effect, from having a call on stock without having been subjected to

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[36] On this basis petitioners (Pet. Br. 20) purport to distinguish *Eason* v. *General Motors Acceptance Corp., supra,* which expressly rejected the purchaser-seller requirement. See pp. 9 n.5, 24, *supra.*

the risk borne by those who had not been deceived into selling.[37] At the same time the *Birnbaum* rule bars suit by an investor who *has* put his funds at risk but who is fraudulently dissuaded from selling shares he already owns.

The *Birnbaum* purchaser-seller requirement simply is not a doctrine placing "reasonable limits on the broad exposure to damage liability that has developed under the section and rule" (Pet. Br. 23). The "limits" imposed by the *Birnbaum* rule are artificial and arbitrary; it denies standing—without regard to defendants' culpability or plaintiffs' ability to prove their claims—to a class of persons for whose protection the statute was enacted.

The *Birnbaum* rule itself has provoked substantial litigation concerning its scope and exceptions. At least in recent years courts that have concluded from the pleadings that a plaintiff might have a meritorious claim have been willing to devise interpretations and exceptions to the *Birnbaum* rule that emphasize the artificial nature of that rule. Compare *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963 (C.A. 2); *Greenstein* v. *Paul*, 400 F.2d 580 (C.A. 2); *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 430 F.2d 355 (C.A. 2). Reversed, 404 U.S. 6, and *Drachman* v. *Harvey*, 453 F.2d 722

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[37] Any inequity in both these situations can be adjusted through judicious allocations of damages appropriate to the particular case. Cf. *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 433-435.

(C.A. 2), reversed on rehearing *en banc*, 453 F.2d 736, with *International Controls Corp.* v. *Vesco*, 490 F.2d 1334 (C.A. 2), certiorari denied, 417 U.S. 932; *James* v. *Gerber Products Co.*, 483 F.2d 944 (C.A. 6); *Travis* v. *Anthes Imperial Ltd.*, 473 F.2d 515 (C.A. 8); *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787 (C.A. 2), certiorari denied, 400 U.S. 822; *Vine* v. *Beneficial Finance Co.*, 374 F.2d 627 (C.A. 2), certiorari denied, 389 U.S. 970; *A. T. Brod & Co.* v. *Perlow*, 375 F.2d 393 (C.A. 2); *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540 (C.A. 2), and *Ruckle* v. *Roto American Corp.*, 339 F.2d 24 (C.A. 2).

The existing exceptions to the *Birnbaum* rule allow some individuals who neither purchased nor sold securities to bring suit, and so already permit the vexatious litigation petitioners fear. Others may sue in the hope of creating additional exceptions to the rule. Litigation over these exceptions can be protracted and costly, as the instant case demonstrates. Indeed, the combined social costs of strike suits falling within the current exceptions and the costs of litigation determining the existence and scope of these exceptions may exceed whatever costs might be incurred from allowing standing to all persons within the class protected by Rule 10b-5 who allege they have been injured by a defendant's violation of it.

We submit that the equitable limitation on vicarious liability for damages we have suggested above, together with appropriate burden-of-proof require-

ments, will sufficiently protect all of the legitimate interests of petitioners and other offerors of securities. This Court should not go further and adopt a rule of standing that places an arbitrary obstacle to recovery in the path of innocent victims and serves primarily to protect violators of the rule.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed on the ground that no "purchaser-seller limitation" is applicable to a private cause of action pursuant to Section 10(b) of the Securities Exchange Act and Rule 10b-5.

Respectfully submitted.

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TOPICAL INDEX

	Page
Table of Citations	ii
ARGUMENT	
I. The Policies Underlying Section 10(b) and Rule 10b-5 are not Served by Permitting Non-Buyers to Sue for Damages	2
II. The SEC Cannot Reconcile the Conflict with the 1933 Act that would Result from Abandonment of the Purchaser-Seller Rule	6
III. Section 12(2) Provides the Only Private Right of Action for Damages Under Section 17(a) of the 1933 Act	7
IV. The Purchaser-Seller Rule Is Sound and Should be Retained	10

Page

TABLE OF CITATIONS

Cases

Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir. 1973) 3

Dyer v. Eastern Trust & Banking Co., 336 F.Supp. 890 (D. Me. 1971) 9

Greater Iowa Corp. v. McLendon, 378 F.2d 783 (8th Cir. 1967) 9

Hardy v. Sanson, 356 F.Supp. 1034 (N.D. Ga. 1973) 9

Marx v. Computer Sciences Corp., 507 F.2d 485 (9th Cir. 1974) 7

SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) 8

Simmons v. Wolfson, 428 F.2d 455 (6th Cir. 1970), *cert. denied*, 400 U.S. 999 (1971) 9

Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971) 2

Trussell v. United Underwriters, Ltd., 228 F.Supp. 757 (D. Colo. 1964) 9

White v. Abrams, 495 F.2d 724 (9th Cir. 1974) 7

Statutes

Securities Act of 1933

§ 12(2), 15 U.S.C. § 77*l*(2) 8

§ 17(a), 15 U.S.C. § 77q(a) 2, 8

Page

Securities Exchange Act of 1934

§ 10(b), 15 U.S.C. § 78j(b) ..... 2 *et seq.*

§ 20(a), 15 U.S.C. § 78t(a) 6

Rules

SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 ..... 2 *et seq.*

Miscellaneous

Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L. J. 171 (1933) 9

3 L. LOSS, SECURITIES REGULATION (1961) 9

Note, 53 N.C.L. REV. 150 (1974) 3

Note, *The "Controlling Persons" Liability of Broker-Dealers for Their Employees' Federal Securities Violations*, 1974 DUKE L.J. 824 6

Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, in Pari Delicto, Indemnification, and Contribution*, 120 U. PA. L. REV. 597 (1972) 6

Scott, *Standing in the Supreme Court — A Functional Analysis*, 86 HARV. L. REV. 645 (1973) 3

No. 74-124

In The
Supreme Court of the United States

October Term, 1974

Blue Chip Stamps, et al.,

Petitioners,

v.

Manor Drug Stores, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE PETITIONERS IN RESPONSE TO THE BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

The Solicitor General has belatedly filed a brief for the Securities and Exchange Commission as *amicus curiae* supporting respondent Manor Drug Stores. Because the SEC calls flatly for abandonment of the purchaser-seller rule — unlike respondent's attempt to carve out an untenable exception to that rule — petitioners submit this reply brief.

I. THE POLICIES UNDERLYING SECTION 10(b) AND RULE 10b-5 ARE NOT SERVED BY PERMITTING NON-BUYERS TO SUE FOR DAMAGES.

From general statements about the philosophy of the 1934 Act the SEC leaps to the conclusion that rule 10b-5 is "to protect *all* persons . . . against making investment decisions on the basis of misleading or inaccurate information." (SEC Br. at 20.) And since, in the SEC's view, all persons are to be protected, it follows that non-purchasing offerees should be able to recover damages for violation of the rule.* (SEC Br. at 21.) The crux of the SEC's position is that to deny a non-buyer a damage remedy would "emasculate the securities laws." (SEC Br. at 23.)

Petitioners have already pointed out that section 10(b) and rule 10b-5 refer only to conduct in connection with the "purchase or sale" of securities and do not include within their express terms any reference to *offers* to sell or purchase. (Pet'rs. Br. at 31.)

In an effort to rewrite section 10(b) and rule 10b-5 to include offers within the scope of their prohibitions, the SEC for the first time in the long history of this case seeks to incorporate into them the language of section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a). The SEC argues that section 17(a) expressly prohibits false or misleading statements "in the offer or sale of any securities," and that the SEC's declared purpose in adopting rule 10b-5 was to extend to purchasers of securi-

* The SEC relies upon *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971), for the proposition that since rule 10b-5 protects creditors of a defrauded seller of securities, it must also protect offerees who are defrauded into not buying securities. But in *Superintendent* the action was brought by one who legally stood in the shoes of the actual defrauded seller, and hence is completely consistent with the purchaser-seller limitation in damage actions.

ties the prohibitions on fraud that section 17(a) imposed upon sellers. (SEC Br. at 11-13; *see* Pet'rs. Br. at 18-19.)

The simple answer to the SEC is that section 17(a) expressly includes offers within its scope while section 10(b) and rule 10b-5 do not. This demonstrates graphically that when Congress intended to reach offers to sell, it knew how to do so in clear and unambiguous language.*

Even if 10(b) and 10b-5 could be read to include non-purchasers within their protective scope, that does not compel the conclusion that a private action for damages should be created for non-purchasers. Where, as here, a private cause of action is wholly a judicial contruct, it is incumbent upon the courts to weigh benefits and detriments in deciding whether, in what form, and under what constraints private litigants should be permitted to supplement the broad enforcement powers of the SEC. *See* Scott, *Standing in the Supreme Court — A Functional Analysis*, 86 HARV. L. REV. 645, 654 n.32 (1973); Note, 53 N.C.L. REV. 150 (1974); *cf. Chris-Craft Industries Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 359 n.11 (2d Cir. 1973). It is this type of measured analysis that underlies the lower court decisions permitting non-selling investors (*i.e.*, those already owning stock in a company) to sue for injunctive relief, but not damages. (*See* Pet'rs. Br. at 31-32.) And it is this approach that has led the courts to reject consistently the SEC's broadside attack on the purchaser-seller rule. (*See* Pet'rs. Br. at 21 n.18.)

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* The Commission further suggests that the phrase "in connection with" the purchase or sale of securities (used in section 10(b) and rule 10b-5) is somehow broader than section 17(a)'s use of the phrase "in" the offer or sale of securities, and concludes that this makes it unnecessary for 10(b) and 10b-5 expressly to include offers within their reach. (SEC Br. at 12-13.) The SEC cites no apposite authority for this illusory grammatical distinction.

The SEC has conceded that practical adverse effects would flow from abolition of the purchaser-seller rule. (SEC Br. at 7, 24-28, 32-33.) This leads the SEC to suggest that two limitations are necessary upon the expansive resultant damage liability to which issuers would be subject. *(Id.)* The "limitations" the SEC sketches are ill-defined, unrealistic and ineffective — and would undoubtedly produce only more litigation respecting the scope of the limitations.

The first limitation would impose, in certain circumstances, an enhanced burden of proof upon plaintiffs who claim they would have bought or sold had they known the true state of affairs respecting the securities in question. (SEC Br. at 24-26.) The SEC suggests that where no "direct relationship" exists between the offeror and the offeree, the plaintiff may have to carry a "heavier burden of proof," *e.g.*, to offer "corroborative evidence" that "tends to show" that his "investment decision" was affected by a misstatement or omission. (SEC Br. at 25-26.)

With evident satisfaction the SEC asserts that under this limitation not every damage claim by a non-purchaser or non-seller would go to the "finders of fact"; rather, only those cases where the non-purchasing, non-selling plaintiff was an "owner of securities or a person to whom an offer to buy or sell had been directed." (SEC Br. at 26.)

The SEC's limitation is illusory. It would apply only when no "direct relationship" existed between the offeror and offeree. But apparently the SEC would find such a relationship and presume causation in all cases where the offerees could be identified. (SEC Br. at 26 n.31.) Thus, the limitation would not apply to the typical underwriting transaction by which most securities are

offered. (Pet'rs. Br. at 28-30.) Even where the proof limitation would apply, the SEC would require only some "corroborative evidence" that "tends to show" that the non-purchaser's investment decision was affected. And the SEC indicates that receipt by an offeree of a prospectus containing material misstatements or omissions would suffice for "corroborative evidence." (SEC Br. at 26 & n.31.) Yet the mere receipt of a prospectus, a press release or some other document says nothing about whether it was read, whether the recipient seriously considered purchasing (as opposed to building his litigation files), or even had the financial capability to buy.

The SEC admits that the reason for such a limitation is to provide some method of filtering out short of full trial that category of cases most likely to contain spurious claims. *(Id.)* There is, however, nothing in the proposed limitation that would permit summary disposition of cases. For example, it would still allow any member of the typically broad class of persons receiving a prospectus to impose upon the issuer the burden of trial on the merits and the risk of substantial liability, regardless of the offeree's ultimate ability to prove his claim.

The second so-called "limitation" proposed by the SEC would impose vicarious liability only where a corporation has benefited from the "wrongful acts of its officers or agents." (SEC Br. at 27-28.) In proposing this limitation the SEC recognizes the unfairness that damage suits by non-purchasers may work on actual investors. *(Id.)* Specifically, non-buyers will be able to sit on the sidelines, watch a stock's course, and then sue and perhaps recover huge damage awards which ultimately will be paid out of the pocket of the company to the detriment

of those who actually invested and put their funds at risk. (SEC Br. at 30-31; *see* Pet'rs. Br. at 33, 41-42.)

The SEC's proposed vicarious liability limitation overlooks the express provisions of section 20(a) of the 1934 Act, 15 U.S.C. § 78t(a). This section imposes upon "control" persons (including corporations) vicarious liability for acts of controlled persons (including corporate officers or directors). *See* Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution,* 120 U. PA. L. REV. 597, 601-08 (1972); Note, *The "Controlling Persons" Liability of Brokers-Dealers for Their Employees' Federal Securities Violations,* 1974 DUKE L.J. 824. In view of this plain congressional policy, it would be wholly inappropriate to circumscribe vicarious liability judicially.

II. THE SEC CANNOT RECONCILE THE CONFLICT WITH THE 1933 ACT THAT WOULD RESULT FROM ABANDONMENT OF THE PURCHASER-SELLER RULE.

The SEC fails to reconcile the conflict between the 1933 and 1934 Acts which would result from abandonment of the purchaser-seller limitation where a "pessimistic" prospectus is at issue. (*See* Pet'rs. Br. at 36-42.) The SEC argues that the prospectus preparer's legal duty under the 1933 Act remains fixed regardless of who can sue for damages (SEC Br. 29 & n.35.) and hence that the "conflict" is irrelevant.

This position is incompatible with the SEC's concession that the 1933 Act's registration provisions embody a "conservative philosophy" toward prospectus drafting and that in complying with this policy "there may be a tendency to overstate risks . . ." (SEC Br. 28, 29 n.35.) Aban-

donment of the purchaser-seller rule in private damage litigation would inevitably undermine the "conservative philosophy" of the 1933 Act by threatening draconic liability for any "tendency to overstate risks."

The SEC soothingly reassures that "it is doubtful that any court would find it appropriate to impose liability upon an offerer who tends somewhat to understate the merits of the securities he is honestly trying to sell, so long as no truly material falsehood or omission is involved." The SEC distinguishes the instant case by inferring a "motive" to discourage sales from the allegation in the complaint that it was not in petitioners' interest to sell the securities. (SEC Br. at 28-29.) The SEC's "motive" test offers no protection to an issuer seeking to comply with the conservative philosophy of the 1933 Act. Motive is not an element of a 10b-5 action. (Pet'rs. Br. at 34-35, 22 n.19.) *See, e.g., Marx v. Computer Sciences Corp.*, 507 F.2d 485, 490 (9th Cir. 1974); *White v. Abrams*, 495 F.2d 724, 730-34 (9th Cir. 1974). Accordingly, there is no room for a trial court to find it not "appropriate" to impose 10b-5 damage liability upon an issuer for an unduly conservative prospectus.

III. SECTION 12(2) PROVIDES THE ONLY PRIVATE RIGHT OF ACTION FOR DAMAGES UNDER SECTION 17(a) OF THE 1933 ACT.

The Commission suggests in a footnote that even if the purchaser-seller rule precludes suit under 10b-5, respondent's "only error in the district court was in failing to allege a cause of action predicated upon Section 17(a) of the Securities Act." (SEC Br. at 12 n.10.) The SEC ignores the weight of authority that there is no private right of action for violation of section 17(a) apart from

the cause of action expressly created by section 12(2) of the 1933 Act, 15 U.S.C. § 77*l*(2). The detailed and delicately balanced provisions of section 12(2)* demonstrate that Congress gave careful consideration to the extent to which civil liability should be imposed for violations of section 17(a). Consequently, there is no basis for judicial implication of an additional remedy for violation of section 17(a), especially one which would nullify the restrictions imposed by Congress under section 12(2). As Judge Friendly has noted,

> "there is unanimity among the commentators, including some who were in a particularly good position to know, that § 17(a)(2) of the 1933 Act — indeed, the whole of § 17 — was intended only to afford a basis for injunctive relief and, on a proper showing, for criminal liability, and was never believed to supplement the actions for damages provided by §§ 11 and 12." *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968) (concurring opinion), *cert. denied*, 394 U.S. 976 (1969).**

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* "Any person who . . .

> "(2) offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, *shall be liable to the person purchasing such security from him*, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security." (Emphasis added.)

** Among those "in a particularly good position to know" was Mr. Justice Douglas, who wrote shortly after passage of the 1933 Act that "[s]ection 17 probably does not enlarge civil remedies

Those courts which have given the question thorough consideration have almost unanimously agreed that section 17(a) creates no private cause of action independent of the remedy provided by Congress in section 12(2). *See, e.g., Greater Iowa Corp. v. McLendon,* 378 F.2d 783, 788-91 (8th Cir. 1967) (Gibson, J., joined by Blackmun & Mehaffy, J.J.); *Simmons v. Wolfson,* 428 F.2d 455, 456 (6th Cir. 1970), *cert. denied,* 400 U.S. 999 (1971); *Trussell v. United Underwriters, Ltd.,* 228 F.Supp. 757 (D. Colo. 1964); *Dyer v. Eastern Trust & Banking Co.,* 336 F.Supp. 890 (D. Me. 1971); *Hardy v. Sanson,* 356 F.Supp. 1034 (N.D. Ga. 1973).

Contrary to the SEC's assertion, these cases have not simply "applied the *Birnbaum* doctrine to actions brought under Section 17(a)," nor have they "disregard[ed] even the unambiguous expression of congressional purpose" behind section 17(a). (SEC Br. at 12 n.10.) Rather, the courts correctly have held that section 12(2) provides the only private cause of action for violation of section 17(a), and that this remedy is expressly limited to actions by "the person purchasing such security . . . to recover the consideration paid . . . ."

Moreover, the SEC is mistaken in stating that respondent here erred "in failing to allege a cause of action predicated upon Section 17(a)." (SEC Br. at 12 n.10.) Respondent did allege such a cause of action by asserting a claim under section 12(2) — a claim which was properly dismissed by the district court on the ground that plaintiff was not a purchaser. (App. at 127.)

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of purchasers. This seems clear by negative implication, since Sections 11 and 12 expressly state the remedies which are available." Douglas & Bates, *The Federal Securities Act of 1933,* 43 YALE L.J. 171, 181-82 (1933). *See also* 3 L. Loss, SECURITIES REGULATION 1784-85 (1961).

IV. THE PURCHASER-SELLER RULE IS SOUND AND SHOULD BE RETAINED.

Petitioners have previously noted the detrimental consequences which would flow from abandoning the purchaser-seller rule — increased liability exposure, enhanced risk of strike suits, extortionate pressure for nuisance settlements of large magnitude. (Pet'rs. Br. 28-30, 34-36, 40-42.)

By contrast, retention of the purchaser-seller rule does not leave an allegedly defrauded non-purchaser without remedy. Common law fraud remedies are available whenever a deliberate misrepresentation has occurred, and respondents have just such an action pending against petitioners in the California state court. (Pet'rs. Br. at 49 n.34.)

Weighing the practical detriments which would result from accepting the SEC's position against the theoretical benefits of "potential investor" protection, it is plain that the purchaser-seller rule should be retained. The rule well fulfills the purposes of section 10(b) and rule 10b-5. The SEC has statutory "standing" to bring broad-ranging injunctive actions against deceptive practices that have harmed or have the prospect of harming actual or potential purchasers or sellers. An existing investor may bring an action for injunctive relief against deceptive practices in connection with purchases and sales of securities. (*See* Pet'rs. Br. at 22, 32.) Finally, one who takes the plunge and becomes a "purchaser" or "seller" of securities can bring an action for damages allegedly suffered because of deceptive practices.

The judicial evolution of the purchaser-seller rule has resulted in a rational framework for the vindication of the section and rule's policies. And the lower courts can be counted on to continue to adapt the doctrine to new

situations as they are presented. Despite the SEC's position, a quarter century evolution of the purchaser-seller rule has not "emasculated" 10b-5, but has effectuated its purposes.

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March, 1975

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

BLUE CHIP STAMPS ET AL. *v.* MANOR DRUG STORES

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 74–124. Argued March 24, 1975—Decided June 9, 1975

Under an antitrust consent decree petitioner New Blue Chip was required to offer a substantial number of common stock shares in its new trading stamp business to retailers like respondent which had previously used the stamp service but which were not shareholders in petitioner's corporate predecessor. Charging that New Blue Chip and other petitioners devised a scheme to dissuade the offerees by means of materially misleading statements containing an overly pessimistic appraisal of the new business from purchasing the securities so that the rejected shares might later be offered to the public at a higher price, respondent brought this class action for damages for violation of the provisions of § 10 (b) of the Securities Exchange Act of 1934 (Act) and Rule 10b–5 promulgated thereunder by the Securities and Exchange Commission (SEC), which make it unlawful to use deceptive devices or make misleading statements "in connection with the purchase or sale of any security." Acting on the basis of the rule enunciated in 1952 in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461, which states that a person who is neither a purchaser nor a seller of securities may not bring an action under § 10 (b) of the Act or the SEC's Rule 10b–5, the District Court dismissed respondent's complaint. The Court of Appeals reversed, concluding that the facts warranted an exception to the *Birnbaum* rule. The court noted that prior cases had held that the rule did not exclude persons owning contractual rights to buy or sell securities and that the offering of securities in this case in compliance with the antitrust decree served the same function as a securities purchase or sales contract. *Held:* A private damages action under Rule 10b–5 is confined to actual purchasers or sellers of

Syllabus

securities and the *Birnbaum* rule bars respondent from maintaining this suit. Pp. 7–32.

(a) The longstanding judicial acceptance of the rule together with Congress' failure to reject its interpretation of § 10 (b) argues significantly in favor of this Court's acceptance of the rule. P. 9.

(b) Extrinsic evidence from the texts of the Act and the Securities Act of 1933 support the *Birnbaum* rule. When Congress wished to provide statutory remedies to others than purchasers or sellers of securities, it did so expressly. Pp. 9–12.

(c) Policy considerations predominantly favor adherence to the rule. Failure to follow it could well result in vexatious litigation caused by a widely expanded class of plaintiffs bringing "strike" suits under Rule 10b–5 and opening litigation to hazy factual issues the proof of which would largely depend on uncorroborated oral testimony to the effect that a person situated like respondent consulted the security issuer's prospectus, and paid attention to it, and that its representations injured him. Pp. 13–26.

(d) Respondent, who derives no entitlement from the antitrust decree and does not otherwise possess any contractual rights relating to the offered stock, occupies the same position as any other disappointed offeree of stock registered under the 1933 Act who claims that an overly pessimistic prospectus has caused him to pass up the chance to purchase, and there is ample evidence that Congress did not intend to extend a private cause of action for money damages to the nonpurchasing offeree of stock registered under the 1933 Act for loss of the opportunity to purchase due to an overly pessimistic prospectus. Pp. 26–30.

(e) The exception to the *Birnbaum* rule that the Court of Appeals relied upon would expose the rule to case-by-case erosion depending upon whether a particular group of plaintiffs was deemed more discrete than potential purchasers in general so as to warrant departing from the rule, and would result in an unsatisfactory basis for establishing liability for the conduct of business transactions. Pp. 31–32.

492 F. 2d 136, reversed.

REHNQUIST, J., delivered the opinion of the Court, in which BURGER, C. J., and STEWART, WHITE, MARSHALL, and POWELL, JJ., joined. POWELL, J., filed a concurring opinion, in which STEWART and MARSHALL, JJ., joined. BLACKMUN, J., filed a dissenting opinion, in which DOUGLAS and BRENNAN, JJ., joined.

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SUPREME COURT OF THE UNITED STATES

No. 74–124

Blue Chip Stamps et al., Petitioners, *v.* Manor Drug Stores, Etc. — On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

[June 9, 1975]

MR. JUSTICE REHNQUIST delivered the opinion of the Court.

This case requires us to consider whether the offerees of a stock offering, made pursuant to an antitrust consent decree and registered under the Securities Act of 1933, 15 U. S. C. § 77a *et seq.* ("the 1933 Act"), may maintain a private cause of action for money damages where they allege that the offeror has violated the provisions of Rule 10b–5 of the Securities and Exchange Commission, but where they have neither purchased nor sold any of the offered shares. See *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (CA2), cert. denied, 343 U. S. 956 (1952).

I

In 1963 the United States filed a civil antitrust action against Blue Chip Stamp Company ("Old Blue Chip"), a company in the business of providing trading stamps to retailers, and nine retailers who owned 90% of its shares. In 1967 the action was terminated by the entry of a consent decree. *United States* v. *Blue Chip Stamp Co.*, 272 F. Supp. 432 (CD Cal. 1967), aff'd *sub nom. Thrifty Shoppers Script Co.* v. *United States*, 389 U. S. 580

(1968).[1] The decree contemplated a plan of reorganization whereby Old Blue Chip was to be merged into a newly formed corporation "New Blue Chip." The holdings of the majority shareholders of Old Blue Chip were to be reduced, and New Blue Chip, one of the petitioners here, was required under the plan to offer a substantial number of its shares of common stock to retailers who had used the stamp service in the past but who were not shareholders in the old company. Under the terms of the plan, the offering to nonshareholder users was to be proportional to past stamp usage and the shares were to be offered in units consisting of common stock and debentures.

The reorganization plan was carried out, the offering was registered with the SEC as required by the 1933 Act, and a prospectus was distributed to all offerees as required by § 5 of that Act, 15 U. S. C. § 77e. Somewhat more than 50% of the offered units were actually purchased. In 1970, two years after the offering, respondent, a former user of the stamp service and therefore an offeree of the 1968 offering, filed this suit in the United States District Court for the Central District of California. Defendants below and petitioners here are Old and New Blue Chip, eight of the nine majority shareholders of Old Blue Chip, and the directors of New Blue Chip (collectively called "Blue Chip").

Respondent's complaint alleged, *inter alia*, that the prospectus prepared and distributed by Blue Chip in connection with the offering was materially misleading in its overly pessimistic appraisal of Blue Chip's status and

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[1] Neither respondent nor any of the members of his alleged class were parties to the antitrust action. The antitrust decree itself provided no plan for the reorganization of Old Blue Chip but instead merely directed the parties to the consent decree to present to the court such a plan. Appendix, at 27, 31.

future prospects. It alleged that Blue Chip intentionally made the prospectus overly pessimistic in order to discourage respondent and other members of the allegedly large class whom it represents from accepting what was intended to be a bargain offer, so that the rejected shares might later be offered to the public at a higher price. The complaint alleged that class members because of and in reliance on the false and misleading prospectus failed to purchase the offered units. Respondent therefore sought on behalf of the alleged class some $21,400,000 in damages representing the lost opportunity to purchase the units; the right to purchase the previously rejected units at the 1968 price, and in addition, it sought some $25,000,000 in exemplary damages.

The only portion of the litigation thus initiated which is before us is whether respondent may base its action on Rule 10 (b)(5) of the Securities and Exchange Commission without having either bought or sold the shares described in the allegedly misleading prospectus. The District Court dismissed respondent's complaint for failure to state a claim upon which relief might be granted.[2] On appeal to the United States Court of Appeals for the Ninth Circuit, respondent pressed only his asserted claim under Rule 10b–5, and a divided panel of the Court of Appeals sustained his position and reversed the District Court.[3] After the Ninth Circuit denied rehearing en banc, we granted Blue Chip's petition for certiorari. 419 U. S. 992. Our consideration of the correctness of the determination of the Court of Appeals requires us to consider what limitations there are on the class of plaintiffs who may maintain a private cause of action for money damages for violation of Rule 10b–5, and whether respondent was within that class.

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[2] The District Court opinion is reported at 339 F. Supp. 35.

[3] The Court of Appeals opinion is reported at 492 F. 2d 136.

II

During the early days of the "New Deal," Congress enacted two landmark statutes regulating securities. The Securities Act of 1933, 48 Stat. 74, as amended, 15 U. S. C. § 77a *et seq.*, was described as "an Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes." The "Securities Exchange Act of 1934," 48 Stat. 881, as amended, 15 U. S. C. § 78a *et seq.*, was described as an Act "to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes."

The various sections of the Act of 1933 dealt at some length with the required contents of registration statements and prospectuses, and expressly provided for private civil causes of action. Section 11 (a) gave a right of action by reason of a false registration statement to "any person acquiring" the security, and § 12 of that Act gave a right to sue the seller of a security who had engaged in proscribed practices with respect to prospectuses and communication to "the person purchasing the said security from him."

The Act of 1934 was divided into two titles. Title I was denominated "regulation of securities exchanges," and Title II was denominated "amendments to Securities Act of 1933." Section 10 of the Act of 1934 made it "unlawful for any person . . . (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as neces-

sary or appropriate in the public interest or for the protection of investors." The "Commission" referred to in the section was the Securities and Exchange Commission created by § 4 (a) of the Act of 1934. Section 29 of that Act provided that "every contract made in violation of any provision of this Title or of any rule or regulation thereunder" should be void.

In 1942, acting under the authority granted to it by § 10 (b) of the Act of 1934, the Commission promulgated Rule 10b–5, providing as follows:

> "§ 240.10b–5 Employment of manipulative and deceptive devices.
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> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
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> "(a) To employ any device, scheme, or artifice to defraud,
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> "(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> "(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> "in connection with the purchase or sale of any security."

Section 10 (b) of the 1934 Act does not by its terms provide an express civil remedy for its violation. Nor does the history of this provision provide any indication that Congress considered the problem of private suits under it at the time of its passage. See, *e. g.*, Note, Implied Liability Under the Securities Exchange Act, 61 Harv. L. Rev. 859, 861 (1948); A. Bromberg, Securities

Law: Fraud—SEC Rule 10b–5 § 2.2, at 300–340 (1968); S. Rep. No. 792, 73d Cong., 2d Sess., p. 5–6 (1934). Similarly there is no indication that the Commission in adopting Rule 10b–5 considered the question of private civil remedies under this provision. SEC Securities Exchange Act Release No. 3230 (1942); Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967); *Birnbaum* v. *Newport Steel Corp., supra,* 193 F. 2d, at 463; 3 L. Loss, Securities Regulation, at 1469 n. 87 (1961).

Despite the contrast between the provisions of Rule 10b–5 and the numerous carefully drawn express civil remedies provided in both the Acts of 1933 and 1934,[4] it was held in 1946 by the United States District Court for the Eastern District of Pennsylvania that there was an implied private right of action under the Rule. *Kardon* v. *National Gypsum Co.,* 69 F. Supp. 512 (1946). This Court had no occasion to deal with the subject until 20-odd years later, and at that time we confirmed with virtually no discussion the overwhelming consensus of the district courts and courts of appeals that such a cause of action did exist. *Superintendent of Insurance* v. *Bankers Life and Casualty Co.,* 404 U. S. 6, 13 n. 9 (1971); *Affiliated Ute Citizens* v. *United States,* 406 U. S. 128, 150–154 (1972). Such a conclusion was, of course, entirely consistent with the Court's recognition in *J. I. Case Corp.* v. *Borak,* 377 U. S. 426, 432 (1964), that private enforcement of Commission rules may "[provide] a necessary supplement to Commission action."

Within a few years after the seminal *Kardon* decision,

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[4] See, *e. g.,* § 11 of the 1933 Act, 15 U. S. C. § 77k; § 12 of the 1933 Act, 15 U. S. C. § 771; § 15 of the 1933 Act, 15 U. S. C. § 77o; § 9 of the 1934 Act, 15 U. S. C. § 78i; § 16 of the 1934 Act, 15 U. S. C. § 78p; § 18 of the 1934 Act, 15 U. S. C. § 78r; § 20 of the 1934 Act, 15 U. S. C. § 78t.

the Court of Appeals for the Second Circuit concluded that the plaintiff class for purposes of a private damage action under § 10 (b) and Rule 10b–5 was limited to actual purchasers and sellers of securities. *Birnbaum* v. *Newport Steel Corp., supra.*

The Court of Appeals in this case did not repudiate *Birnbaum;* indeed, another panel of that court (in an opinion by Judge Ely) had but a short time earlier affirmed the rule of that case. *Mount Clemmons Industries* v. *Bell,* 464 F. 2d 339 (CA9 1972). But in this case a majority of the Court of Appeals found that the facts warranted an exception to the *Birnbaum* rule. For the reasons hereinafter stated, we are of the opinion that *Birnbaum* was rightly decided, and that it bars respondent from maintaining this suit under Rule 10b–5.

III

The panel which decided *Birnbaum* consisted of Chief Judge Swan and Judges Learned Hand and Augustus Hand: the opinion was written by the latter. Since both § 10 (b) and Rule 10b–5 proscribed only fraud "in connection with the purchase or sale" of securities, and since the history of § 10 (b) revealed no congressional intention to extend a private civil remedy for money damages to other than defrauded purchasers or sellers of securities, in contrast to the express civil remedy provided by § 16 (b) of the 1934 Act, the court concluded that the plaintiff class in a Rule 10b–5 action was limited to actual purchasers and sellers. 193 F. 2d 461, 463–464.

Just as this Court had no occasion to consider the validity of the *Kardon* holding that there was a private cause of action under Rule 10b–5 until 20-odd years later, nearly the same period of time has gone by between the *Birnbaum* decision and our consideration of the case now before us. As with *Kardon,* virtually all lower

federal courts facing the issue in the hundreds of reported cases presenting this question over the past quarter century have reaffirmed *Birnbaum*'s conclusion that the plaintiff class for purposes of § 10 (b) and Rule 10b–5 private damage action is limited to purchasers and sellers of securities. See 6 L. Loss, Securities Regulation, at 3617. See, *e. g.*, *Haberman* v. *Murchison*, 468 F. 2d 1305, 1311 (CA2 1972); *Landry* v. *FDIC*, 486 F. 2d 139, 156–157 (CA3 1973), cert. denied, 416 U. S. 960 (1974); *Sargent* v. *Genesco*, 492 F. 2d 750, 763 (CA5 1974); *Simmons* v. *Wolfson*, 428 F. 2d 455, 456 (CA6 1970), cert. denied, 400 U. S. 999 (1971); *City National Bank* v. *Vanderboom*, 422 F. 2d 221, 227–228 (CA8), cert. denied, 399 U. S. 905 (1970); *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339 (CA9 1972); *Jensen* v. *Voyles*, 393 F. 2d 131, 133 (CA10 1967). Compare *Eason* v. *General Motors Acceptance Corp.*, 490 F. 2d 654 (CA7 1973), cert. denied, 416 U. S. 960 (1974), with *Dasho* v. *Susquehanna Corp.*, 380 F. 2d 262 (CA7), cert. denied, 389 U. S. 977 (1967).

In 1957 and again in 1959, the Securities and Exchange Commission sought from Congress amendment of § 10 (b) to change its wording from "in connection with the purchase or sale or any security" to "in connection with the purchase or sale of, *or any attempt to purchase or sell*, any security." (Emphasis added.) 103 Cong. Rec. 11636 (1957); SEC Legislation, Hearings before Subcom. of Sen. Com. on Banking & Currency on S. 1178–1182, 86th Cong., 1st Sess., 367–368 (1959); S. 2545, 85th Cong., 1st Sess. (1957); S. 1179, 86th Cong., 1st Sess. (1959). In the words of a memorandum submitted by the Commission to a congressional committee, the purpose of the proposed change was "to make section 10 (b) also applicable to manipulative activities in connection with any attempt to purchase or sell any

security." Hearings on S. 1178–1182, *supra*, at 331. Opposition to the amendment was based on fears of the extension of civil liability under § 10 (b) that it would cause. *Id.*, at 368. Neither change was adopted by Congress.

The longstanding acceptance by the courts, coupled with Congress' failure to reject *Birnbaum*'s reasonable interpretation of the wording of § 10 (b), wording which is directed towards injury suffered "in connection with the purchase or sale" of securities,[5] argues significantly in favor of acceptance of the *Birnbaum* rule by this Court. *Blau* v. *Lehman*, 368 U. S. 403, 413 (1962).

Available extrinsic evidence from the texts of the 1933 and 1934 Acts as to the congressional scheme in this regard, though not conclusive, supports the result reached by the *Birnbaum* court. The wording of § 10 (b) directed at fraud "in connection with the purchase or sale" of securities stands in contrast with the parallel antifraud provision of the 1933 Act, § 17 (a),

[5] MR. JUSTICE BLACKMUN, dissenting, *post*, at 4, finds support in the literal language of § 10 (b) since he concludes that in his view "the word 'sale' ordinarily and naturally may be understood to mean not only a single, individualized act transferring property from one party to another, but also the generalized event of public disposal of property through advertisement, auction, or some other market mechanism." But this ignores the fact that this carefully drawn statute itself defines the term "sale" for purposes of the Act and as we have noted, *infra*, at 26 n. 13, Congress expressly deleted from the Act's definition events such as offers and advertisements which may ultimately lead to a completed sale. Moreover, the extension of the word 'sale' to include offers is quite incompatible with Congress' separate definition and use of these terms in the 1933 and 1934 Acts. Cf. § 2 (3) of the 1933 Act, 15 U. S. C. § 77b (3). Beyond this, the wording of § 10 (b), making fraud *in connection with the purchase or sale of a security* a violation of the Act, is surely badly strained when construed to provide a cause of action not to purchasers and sellers of securities, but to the world at large.

15 U. S. C. § 77q,[6] reaching fraud "in the offer or sale" of securities. Cf. § 5 of the 1933 Act, 15 U. S. C. 77e. When Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly. Cf. § 16 (b) of the 1934 Act, 15 U. S. C. § 78p.

Section 28 (a) of the 1934 Act, 15 U. S. C. § 78bb, which limits recovery in any private damage action brought under the 1934 Act to "actual damages," likewise provides some support for the purchaser-seller rule. See, *e. g.*, A. Bromberg, Securities Law: Fraud—SEC–Rule 10b–5 § 8.8, at 221 (1968). While the damages suffered by purchasers and sellers pursuing a § 10 (b) cause of action may on occasion be difficult to ascertain, *Affiliated Ute Citizens* v. *United States*, *supra*, at 155,

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[6] § 17 (a) of the 1933 Act provides in wording virtually identical to that of Rule 10b–5 with the exception of the italicized portion that:

"It shall be unlawful for any person *in the offer* or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." (Emphasis added.)

We express, of course, no opinion on whether § 17 (a) in light of the express civil remedies of the 1933 Act gives rises to an implied cause of action. Compare *Greater Iowa Corp.* v. *McLendon*, 378 F. 2d 783, 788, 791 (CA8 1967), with *Fishman* v. *Raytheon Mfg. Corp.*, 188 F. 2d 783, 787 (CA2 1951). See, *e. g.*, *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 867 (CA2 1968) (Opinion of Friendly, J., concurring), cert. denied, 394 U. S. 976 (1969); 3 L. Loss, Securities Regulation 1785 (1961).

in the main such purchasers and sellers at least seek to base recovery on a demonstrable number of shares traded. In contrast, a putative plaintiff, who neither purchases nor sells securities but sues instead for intangible economic injury such as loss of a noncontractual opportunity to buy or sell, is more likely to be seeking a largely conjectural and speculative recovery in which the number of shares involved will depend on the plaintiff's subjective hypothesis. Cf. *Estate Counseling Service* v. *Merrill, Lynch, Pierce, Fenner & Smith,* 303 F. 2d 527, 533 (CA10 1962); *Levine* v. *Seilon, Inc.,* 439 F. 2d 328, 335 (CA2 1971); *Wolf* v. *Frank,* 477 F. 2d 467, 478 (CA2 1973).

One of the justifications advanced for implication of a cause of action under § 10 (b) lies in § 29 (b) of the 1934 Act, 15 U. S. C. § 78cc, providing that a contract made in violation of any provision of the 1934 Act is voidable at the option of the deceived party.[7] See, *e. g.*, *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514 (ED Pa. 1946); *Slavin* v. *Germantown Fire Insurance Co.*, 174 F. 2d 799, 815 (CA3 1949); *Fischman* v.

[7] § 29 (b) of the 1934 Act provides in part:

"Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void, (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation. . . ."

Cf. *Decker* v. *Independent Shares Corp.*, 311 U. S. 282 (1940).

Raytheon Manufacturing Co., 188 F. 2d 783, 787 n. 4 (CA2 1951); A. Bromberg, Securities Regulation: Fraud—SEC Rule 10b–5 § 2.4 (1)(b) (1968). But that justification is absent when there is no actual purchase or sale of securities, or a contract to do so, affected or tainted by a violation of § 10 (b). Cf. *Mount Clemens Industries, Inc.* v. *Bell*, *supra*.

The principal express nonderivative private civil remedies, created by Congress contemporaneously with the passage of § 10 (b), for violations of various provisions of the 1933 and 1934 Acts are by their terms expressly limited to purchasers or sellers of securities. Thus § 11 (a) of the 1933 Act confines the cause of action it grants to "any person acquiring the security" while the remedy granted by § 12 of that Act is limited to the "person purchasing the said security." Section 9 of the 1934 Act, prohibiting a variety of fraudulent and manipulative devices, limits the express civil remedy provided for its violation to "any person who shall purchase or sell any security" in a transaction affected by a violation of the provision. Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . ." It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.[8]

[8] MR. JUSTICE BLACKMUN, dissenting, *post*, at 1, finds the *Birnbaum* rule incompatible with the purpose and history of § 10 (b) and Rule 10b–5. But it is worthy of more than passing note that the history of Rule 10b–5 itself, recounted at some length in the dissent, *post*, at 6–7, strongly supports the purchaser-seller limitation. As the dissent notes, Rule 10b–5 was adopted in order to

Having said all this, we would by no means be understood as suggesting that we are able to divine from the language of § 10 (b) the express "intent of Congress" as to the contours of a private cause of action under Rule 10b–5. When we deal with private actions under Rule 10b–5, we deal with a judicial oak which has grown from little more than a legislative acorn. Such growth may be quite consistent with the congressional enactment and with the role of the federal judiciary in interpreting it, see *J. I. Case* v. *Borak*, *supra*, but it would be disingenuous to suggest that either Congress in 1934 or the Securities and Exchange Commission in 1942 foreordained the present state of the law with respect to Rule 10b–5. It is therefore proper that we consider, in addition to the factors already discussed, what may be described as policy considerations when we come to flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance.

Three principal classes of potential plaintiffs are presently barred by the *Birnbaum* rule. First are

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close "a loophole in the protections against fraud . . . by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase." See SEC Release No. 3230 (May 21, 1942); Remarks of Milton Freeman, Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967). The modest aims and origins of the Rule as recounted by the dissent stand in stark contrast with its far ranging conclusion that a remedy exists under 10b–5 whenever there is "a logical nexus between the alleged fraud and the purchase or sale of a security." *Post*, at 10. On these facts, as we have indicated, *infra*, at 29, extension of a 10b–5 cause of action, far from closing an unforeseen loophole, would extend a private right of action for misrepresentations in a 1933 Act prospectus to those whom Congress excluded from the express civil remedies provided in the 1933 Act to cover such a violation.

potential purchasers of shares, either in a new offering or on the Nation's post-distribution trading markets, who allege that they decided not to purchase because of an unduly gloomy representation or the omission of favorable material which made the issuer appear to be a less favorable investment vehicle than it actually was. Second are actual shareholders in the issuer who allege that they decided not to sell their shares because of an unduly rosy representation or a failure to disclose unfavorable material. Third are shareholders, creditors, and perhaps others related to an issuer who suffered loss in the value of their investment due to corporate or insider activities in connection with the purchase or sale of securities which violate Rule 10b–5. It has been held that shareholder members of the second and third of these classes may frequently be able to circumvent the *Birnbaum* limitation through bringing a derivative action on behalf of the corporate issuer if the latter is itself a purchaser or seller of securities. See, *e. g., Schoenbaum* v. *Firstbrook*, 405 F. 2d 215, 219 (CA2 1968), cert. denied *sub nom. Manley* v. *Schoenbaum*, 395 U. S. 906 (1969). But the first of these classes, of which respondent is a member, can not claim the benefit of such a rule.

A great majority of the many commentators on the issue before us have taken the view that the *Birnbaum* limitation on the plaintiff class in a Rule 10b–5 action for damages is an arbitrary restriction which unreasonably prevents some deserving plaintiffs from recovering damages which have in fact been caused by violations of Rule 10b–5. See, *e. g., Loiwenfels*, The Demise of the *Birnbaum* Doctrine: A New Era for Rule 10b–5, 54 Va. Law Rev. 268 (1968). The Securities and Exchange Commission has filed an *amicus* brief in this case espousing that same view. We have no doubt that this is

indeed a disadvantage of the *Birnbaum* rule,[9] and if it had no countervailing advantages it would be undesirable as a matter of policy, however much it might be supported by precedent and legislative history. But we are of the opinion that there are countervailing advantages to the *Birnbaum* rule, purely as a matter of policy, although those advantages are more difficult to articulate than is the disadvantage.

There has been widespread recognition that litigation under Rule 10b–5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general. This fact was recognized by Judge Browning in his opinion for the majority of the Court of Appeals in this case, 492 F. 2d 141, and by Judge Hufstedler in her dissenting opinion when she said:

> "The purchaser-seller rule has maintained the balances built into the congressional scheme by permitting damage actions to be brought only by those persons whose active participation in the marketing transaction promises enforcement of the statute without undue risk of abuse of the litigation process

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[9] Obviously this disadvantage is attenuated to the extent that remedies are available to nonpurchasers and nonsellers under state law. Cf. § 28 of the Securities Exchange Act of 1934, 15 U. S. C. § 78bb. See *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F. 2d 963, 969 (CA2 1969), cert. denied, 399 U. S. 909 (1970). Thus for example in *Birnbaum* itself, while the plaintiffs found themselves without federal remedies, the conduct alleged as the gravamen of the federal complaint later provided the basis for recovery in a cause of action based on state law. See 3 L. Loss, Securities Regulation 1469 (1961). And in the immediate case, respondent has filed a state court class action held in abeyance pending the outcome of this suit. *Manor Drug Stores* v. *Blue Chip Stamps*, No. C–5652 (Superior Court, County of Los Angeles, Cal.).

and without distorting the securities market." 492 F. 2d 147.

Judge Friendly in commenting on another aspect of Rule 10b–5 litigation has referred to the possibility that unduly expansive imposition of civil liability "will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers . . . ." *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 867 (CA2 1968) (concurring opinion). See also Boone and McGowan, Standing to Sue under Rule 10b–5, 49 Tex. L. Rev. 617, 648–649 (1971).

We believe that the concern expressed for the danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b–5 is founded in something more substantial than the common complaint of the many defendants who would prefer avoiding lawsuits entirely to either settling them or trying them. These concerns have two largely separate grounds.

The first of these concerns is that in the field of federal securities laws governing disclosure of information even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment. The very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit. See, *e. g.*, Sargent, The SEC and the Individual Investor: Restoring His Confidence in the Market, 60 Va. L. Rev. 533, 562–572 (1974); Dooley, The Effects of Civil Liability on Investment Banking and the New Issues Market, 58 Va. L. Rev. 777, 822–843 (1972).

Congress itself recognized the potential for nuisance

or "strike" suits in this type of litigation, and in the 1934 Act amended § 11 of the 1933 Act to provide that:

> "In any suit under this or any other section of this Title the Court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorneys' fees. . . ." (48 Stat. 881, 908.)

Senator Fletcher, Chairman of the Senate Banking and Finance Committee, in introducing Title II of the 1934 Act on the floor of the Senate, stated in explaining the amendment to § 11 (e) that "[t]his amendment is the most important of all." 78 Cong. Rec. 8669. Among its purposes was to provide "a defense against blackmail suits." *Ibid.*

Where Congress in those sections of the 1933 Act which expressly conferred a private cause of action for damages, adopted a provision uniformly regarded as designed to deter "strike" or nuisance actions, *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541, 548–549, that fact alone justifies our consideration of such potential in determining the limits of the class of plaintiffs who may sue in an action wholly implied from the language of the 1934 Act.

The potential for possible abuse of the liberal discovery provisions of the federal rules may likewise exist in this type of case to a greater extent than they do in other litigation. The prospect of extensive deposition of the defendant's officers and associates and the concomitant opportunity for extensive discovery of business documents, is a common occurrence in this and similar types of litigation. To the extent that this process eventually produces relevant evidence which is useful in determining the merits of the claims asserted by the parties, it bears the imprimatur of the Federal Rules of Civil Procedure

and of the many cases liberally interpreting them. But to the extent that it permits a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence, it is a social cost rather than a benefit. Yet to broadly expand the class of plaintiffs who may sue under Rule 10b–5 would appear to encourage the least appealing aspect of the use of the discovery rules.

Without the *Birnbaum* rule, an action under § 10b–5 will turn largely on which oral version of a series of occurrences the jury may decide to credit, and therefore no matter how improbable the allegations of the plaintiff, the case will be virtually impossible to dispose of prior to trial other than by settlement. In the words of Judge Hufstedler's dissenting opinion in the Court of Appeals:

> "The great ease with which plaintiffs can allege the requirements for the majority's standing rule and the greater difficulty that plaintiffs are going to have proving the allegations suggests that the majority's rule will allow a relatively high proportion of 'bad' cases into court. The risk of strike suits is particularly high in such cases; although they are difficult to prove at trial, they are even more difficult to dispose of before trial." 492 F. 2d, at 147 n. 9.

The *Birnbaum* rule, on the other hand, permits exclusion prior to trial of those plaintiffs who were not themselves purchasers or sellers of the stock in question. The fact of purchase of stock and the fact of sale of stock are generally matters which are verifiable by documentation, and do not depend upon oral recollection, so that failure to qualify under the *Birnbaum* rule is a matter that can normally be established by the defendant

either on a motion to dismiss or on a motion for summary judgment.

Obviously there is no general legal principle that courts in fashioning substantive law should do so in a manner which makes it easier, rather than more difficult, for a defendant to obtain a summary judgment. But in this type of litigation, where the mere existence of an unresolved lawsuit has settlement value to the plaintiff not only because of the possibility that he may prevail on the merits, an entirely legitimate component of settlement value, but because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event, but cannot be proven so before trial, such a factor is not to be totally dismissed. The *Birnbaum* rule undoubtedly excludes plaintiffs who have in fact been damaged by violations of Rule 10b–5, and to that extent it is undesirable. But it also separates in a readily demonstrable manner the group of plaintiffs who actually purchased or actually sold, and whose version of the facts is therefore more likely to be believed by the trier of fact, from the vastly larger world of potential plaintiffs who might successfully allege a claim but could seldom succeed in proving it. And this fact is one of its advantages.

The second ground for fear of vexatious litigation is based on the concern that, given the generalized contours of liability, the abolition of the *Birnbaum* rule would throw open to the trier of fact many rather hazy issues of historical fact the proof of which depended almost entirely on oral testimony. We in no way disparage the worth and frequent high value of oral testimony when we say that dangers of its abuse appear to exist in this type of action to a peculiarly high degree. The brief of the Securities and Exchange Commission, while opposing the adoption of the *Birnbaum* rule by this Court,

states that it agrees with petitioners "that the effect, if any, of a deceptive practice on someone who has neither purchased nor sold securities may be more difficult to demonstrate than is the effect on a purchaser or seller." Brief, pp. 24–25. The brief also points out that frivolous suits can be brought whatever the rules of standing, and reminds us of this Court's recognition "in a different context" that "the expense and annoyance of litigation is 'part of the social burden of living under government.'" *Petroleum Exploration, Inc.* v. *Public Service Comm'n,* 304 U. S. 209, 222. The Commission suggests that in particular cases additional requirements of corroboration of testimony and more limited measure of damages would correct the dangers of an expanded class of plaintiffs.

But the very necessity, or at least the desirability, of fashioning unique rules of corroboration and damages as a correlative to the abolition of the *Birnbaum* rule suggests that the rule itself may have something to be said for it.

In considering the policy underlying the *Birnbaum* rule, it is not inappropriate to advert briefly to the tort of misrepresentation and deceit, to which a claim under § 10b–5 certainly has some relationship. Originally under the common law of England such an action was not available to one other than a party to a business transaction. That limitation was eliminated in *Pasley* v. *Freeman,* 3 Term Rep. 51, 100 Eng. Rep. 450 (1789). Under the earlier law the misrepresentation was generally required to be one of fact, rather than opinion, but that requirement, too, was gradually relaxed. Lord Bowen's famous comment in *Edgington* v. *Fitzmaurice,* that "the state of a man's mind is as much a fact as the state of his digestion," 1882, L. R. 29 Ch. Div. 359, suggests that this distinction, too, may have been somewhat arbitrary.

And it has long been established in the ordinary case of deceit that a misrepresentation which leads to a refusal to purchase or to sell is actionable in just the same way as a representation which leads to the consummation of a purchase or sale. *Butler* v. *Watkins*, 9 Wall. 815 (1871). These aspects of the evolution of the tort of deceit and misrepresentation suggest a direction away from rules such as *Birnbaum*.

But the typical fact situation in which the classic tort of misrepresentation and deceit evolved was light years away from the world of commercial transactions to which Rule 10b–5 is applicable. The plaintiff in *Butler, supra*, for example, claimed that he had held off the market a patented machine for tying cotton bales which he had developed by reason of the fraudulent representations of the defendant. But the report of the case leaves no doubt that the plaintiff and defendant met with one another in New Orleans, that one presented a draft agreement to the other, and that letters were exchanged relating to that agreement. Although the claim to damages was based on an allegedly fraudulently induced decision not to put the machines on the market, the plaintiff and the defendant had concededly been engaged in the course of business dealings with one another, and would presumably have recognized one another on the street had they met.

In today's universe of transactions governed by the Securities Exchange Act of 1934, privity of dealing or even personal contact between potential defendant and potential plaintiff is the exception and not the rule. The stock of issuers is listed on financial exchanges utilized by tens of millions of investors and corporate representations reach a potential audience, encompassing not only the diligent few who peruse filed corporate reports or the sizable number of subscribers to financial journals, but

the readership of the Nation's daily newspapers. Obviously neither the fact that issuers or other potential defendants under Rule 10b–5 reach a large number of potential investors, or the fact that they are required by law to make their disclosures conform to certain standards, should in any way absolve them from liability for misconduct which is proscribed by Rule 10b–5.

But in the absence of the *Birnbaum* rule, it would be sufficient for a plaintiff to prove that he had failed to purchase or sell stock by reason of a defendant's violation of Rule 10b–5. The manner in which the defendant's violation caused the plaintiff to fail to act could be as a result of the reading of a prospectus, as respondent claims here, but it could just as easily come as a result of a claimed reading of information contained in the financial pages of a local newspaper. Plaintiff's proof would not be that he purchased or sold stock, a fact which would be capable of documentary verification in most situations, but instead that he decided *not* to purchase or sell stock. Plaintiff's entire testimony could be dependent upon uncorroborated oral evidence of many of the crucial elements of his claim, and still be sufficient to go to the jury. The jury would not even have the benefit of weighing the plaintiff's version against the defendant's version, since the elements to which the plaintiff would testify would be in many cases totally unknown and unknowable to the defendant. The very real risk in permitting those in respondent's position to sue under Rule 10b–5 is that the door will be open to recovery of substantial damages on the part of one who offers only his own testimony to prove that he ever consulted a prospectus of the issuer, that he paid any attention to it, or that the representations contained in it damaged him.[10]

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[10] The SEC, recognizing the necessity for limitations on non-

The virtue of the *Birnbaum* rule, simply stated, in this situation, is that it limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates. And their dealing in the security, whether by way of purchase or sale, will generally be an objectively demonstrable fact in an area of the law otherwise very much de-

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purchaser, nonseller plaintiffs in the absence of the *Birnbaum* rule, suggests two such limitations to mitigate the practical adverse effects flowing from abolition of the rule. First it suggests requiring some corroborative evidence in addition to oral testimony tending to show that the investment decision of a plaintiff was affected by an omission or misrepresentation. SEC Brief, at 25–26. Apparently ownership of stock or receipt of a prospectus or press release would be sufficient corroborative evidence in the view of the SEC to reach the jury. We do not believe that such a requirement would adequately respond to the concerns in part underlying the *Birnbaum* rule. Ownership of stock or receipt of a prospectus says little about whether a plaintiff's investment decision was affected by a violation of Rule 10b–5 or whether a decision was even made. Second, the SEC would limit the vicarious liability of corporate issuers to nonpurchasers and nonsellers to situations where the corporate issuer has been unjustly enriched by a violation. We have no occasion to pass upon the compatibility of this limitation with § 20 (a) of the 1934 Act, 15 U. S. C. § 78t (a). We do not believe that this proposed limitation is relevant to the concerns underlying in part the *Birnbaum* rule as we have expressed them. We are not alone in feeling that the limitations proposed by the SEC are not adequate to deal with the adverse effects which would flow from abolition of the *Birnbaum* rule. See, *e. g.*, *Vine* v. *Beneficial Finance Co.*, 374 F. 2d 627, 636 (CA2), cert. denied, 389 U. S. 970 (1967); *Iroquois Industries Inc.* v. *Syracuse China Corp.*, 417 F. 2d 963, 967 (CA2 1969), cert. denied, 399 U. S. 909 (1970); *Rekant* v. *Desser*, 425 F. 2d 872, 879 (CA5 1970); *GAF Corp.* v. *Milstein*, 453 F. 2d 709, 721 (CA2 1971), cert. denied, 406 U. S. 910 (1972); *Drachman* v. *Harvey*, 453 F. 2d 722, 736, 738 (CA2 1972) (in banc); *Mount Clements Industries, Inc.* v. *Bell*, 464 F. 2d 339, 341 (CA9 1972).

pendent upon oral testimony. In the absence of the *Birnbaum* doctrine, bystanders to the securities marketing process could await developments on the sidelines without risk, claiming that inaccuracies in disclosure caused nonselling in a falling market and that unduly pessimistic predictions by the issuer followed by a rising market caused them to allow retrospectively golden opportunities to pass.

While much of the development of the law of deceit has been the elimination of artificial barriers to recovery on just claims, we are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good. In *Ultramares Corp.* v. *Touche*, 255 N. Y. 170, 174 N. E. 441, Chief Judge Cardozo observed with respect to "a liability in an indeterminate amount for an indeterminate time to an indeterminate class" that:

> "The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of the duty that exposes to these consequences." 174 N. E., at 444.

In *Herpich* v. *Wallace*, 430 F. 2d 792, 804–805 (CA5 1970), a case adopting the *Birnbaum* limitation on the class of plaintiffs who might bring an action for damages based on a violation of Rule 10b–5, Judge Ainsworth expressed concern similar to those expressed by Chief Judge Cardozo. Judge Stevens, writing in *Eason* v. *General Motors Acceptance Corp.*, CA7, 490 F. 2d 654, stated that court's view that these concerns were unduly emphasized, and went on to say that "We may not for that reason reject what we believe to be a correct interpretation of the statute or the rule." 490 F. 2d, at

660. He relied in part on the view that Rule 10b–5 should be interpreted, in keeping with this Court's repeated admonition, "not technically and restrictively, but flexibly to effectuate its remedial purposes." *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, 151 (1972).

We quite agree that if Congress had legislated the elements of a private cause of action for damages, the duty of the Judicial Branch would be to administer the law which Congress enacted; the judiciary may not circumscribe a right which Congress has conferred because of any disagreement it might have with Congress about the wisdom of creating so expansive a liability. But as we have pointed out, we are not dealing here with any private right created by the express language of § 10b or of Rule 10b–5. No language in either of those provisions speaks at all to the contours of a private cause of action for their violation. However flexibly we may construe the language of both provisions, nothing in such construction militates against the *Birnbaum* rule. We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited one way or another unless and until Congress addresses the question. Given the peculiar blend of legislative, administrative, and judicial history which now surrounds Rule 10b–5, we believe that practical factors to which we have adverted, and to which other courts have referred, are entitled to a good deal of weight.

Thus we conclude that what may be called considerations of policy, which we are free to weigh in deciding this case, are by no means entirely on one side of the scale. Taken together with the precedental support for the *Birnbaum* rule over a period of more than 20 years, and the consistency of that rule with what we can glean

from the intent of Congress, they lead us to conclude that it is a sound rule and should be followed.

IV

The majority of the Court of Appeals in this case expressed no disagreement with the general proposition that one asserting a claim for damages based on the violation of Rule 10b–5 must be either a purchaser or seller of securities. However, it noted that prior cases have held that persons owning contractual rights to buy or sell securities are not excluded by the *Birnbaum* rule. Relying on these cases, it concluded that respondent's status as an offeree pursuant to the terms of the consent decree served the same function, for purposes of delimiting the class of plaintiffs, as is normally performed by the requirement of a contractual relationship. 492 F. 2d, at 142.

The Court of Appeals recognized, and respondent concedes here,[11] that a well-settled line of authority from this Court establishes that a consent decree is not enforceable directly or in collateral proceedings by those who are not parties to it even though they were intended to be benefited by it. *United States* v. *Armour and Co.*, 402 U. S. 673 (1971); *Buckeye Co.* v. *Hocking Valley Co.*, 269 U. S. 42 (1925).[12]

A contract to purchase or sell securities is expressly defined by § 3 (a) of the 1934 Act, 15 U. S. C. § 78c (a),[13]

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[11] See Respondent's Brief, at 60.

[12] See n. 1, *supra*; 492 F. 2d, at 144 n. 3 (Opinion of Hufstedler, J., dissenting).

[13] Section 3 (a)(13) of the 1934 Act, 15 U. S. C. § 78c (a)(13) provides:

"The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."

[*Footnote 13 is continued on p. 27*]

as a purchase or sale of securities for the purposes of that Act. Unlike respondent, who had no contractual right or duty to purchase Blue Chip's securities, the holders of puts, calls, options and other contractual rights or duties to purchase or sell securities have been recognized as "purchasers" or "sellers" of securities for purposes of Rule 10b–5, not because of a judicial conclusion that they were similarly situated to "purchasers" or "sellers," but because the definitional provisions of the 1934 Act themselves grant them such a status.

Even if we were to accept the notion that the *Birn-*

Section 3 (a) (14) of the 1934 Act, 15 U. S. C. § 78c (a) (14) provides:

"The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

These provisions as enacted starkly contrast with the wording of the bill which became the 1934 Act when it emerged from committee and was presented on the Senate floor by Senator Fletcher, the chairman of the Senate Committee on Banking and Finance. See S. 2693, 73rd Cong., 2d Sess. (1934); 78 Cong. Rec. 2265. Section 3 (11) of the bill as presented to the Senate provided:

"The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire, *attempt or offer to acquire or solicitation of an offer to sell a security or any interest in a security.*" (Emphasis added.)

And Section 3 (12) of the bill provided:

"The terms 'sale' and 'sell' each include any contract of sale or disposition of, contract to sell or dispose of, *attempt or offer to dispose of, or solicitation of an offer to buy a security or any interest therein.*" (Emphasis added.)

During consideration of the bill on the Senate floor, the ambit of these provisions was narrowed through amendment into the present wording of Sections 3 (a) (13) and (14) in which form they were enacted as a part of the Act. 48 Stat. 884. In arguing that it, as an offeree of stock, ought to be treated as a purchaser or seller for purposes of the Act, respondent is in effect seeking a judicial reinsertion of language into the Act that Congress had before it but deleted prior to passage.

baum rule could be circumvented on a case-by-case basis through particularized judicial inquiry into the facts surrounding a complaint, this respondent and the members of his alleged class would be unlikely candidates for such a judicially created exception. While the *Birnbaum* rule has been flexibly interpreted by lower federal courts,[14] we have been unable to locate a single decided case from any court in the 20-odd years of litigation since the *Birnbaum* decision which would support the right of persons who were in the position of respondent here to bring a private suit under Rule 10b–5. Respondent was not only not a buyer or seller of any security but it was not even a shareholder of the corporate petitioners.

As indicated, the 1934 Act, under which respondent seeks to assert a cause of action, is general in scope but chiefly concerned with the regulation of post-distribution trading on the Nation's stock exchanges and securities trading markets. The 1933 Act is a far narrower statute chiefly concerned with disclosure and fraud in connection with offerings of securities—primarily, as here, initial distributions of newly issued stock from corporate issuers. 1 L. Loss, Securities Regulation 130–131 (1961). Respondent, who derives no entitlement from the antitrust consent decree and does not otherwise possess any contractual rights relating to the offered stock, stands in the same position as any other disappointed offeree of a stock offering registered under the 1933 Act who claims that an overly pessimistic prospectus, prepared and distributed as required by §§ 5, 10 of the 1933 Act, has caused it to allow its opportunity to purchase to pass.

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[14] Our decision in *SEC* v. *National Securities, Inc.*, 393 U. S. 453 (1969), established that the purchaser-seller rule imposes no limitation on the standing of the SEC to bring actions for injunctive relief under § 10 (b) and Rule 10b–5.

There is strong evidence that application of the *Birnbaum* rule to preclude suit by the disappointed offeree of a registered 1933 Act offering under Rule 10b–5 furthers the intention of Congress as expressed in the 1933 Act.[15] Congress left little doubt that its purpose in imposing the prospectus and registration requirements of the 1933 Act was to prevent "the high pressured salesmanship rather than careful counsel," causing inflated new issues, through direct limitation by the SEC of "the selling arguments hitherto employed." H. R. Rep. No. 85, 73d Cong., 1st Sess., 2, 8 (1933).

> "Any objection that the compulsory incorporation in selling literature and sales argument of substantially all information concerning the issue, will frighten the buyer with the intricacy of the transaction states one of the best arguments for the provision." *Id.*, at 8.

The SEC, in accord with the congressional purposes, specifically requires prominent emphasis be given in filed registration statements and prospectuses to material adverse contingencies. See, *e. g.*, SEC Securities Act Release No. 4936, Guides for the Preparation and Filing of Registration Statements, n. 6, ¶ 6 (1968); *Universal Camera Corp.*, 19 S. E. C. 648, 654–656 (1945); Wheat and Blackstone, Guideposts for a First Public Offering, 15 Bus. Lawyer 539, 560–562 (1960).

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[15] Blue Chip did not here present the question of whether an implied action under § 10 (b) of the 1934 Act and Rule 10b–5 will lie for actions made a violation of the 1933 Act and the subject of express civil remedies under the 1933 Act. We therefore have no occasion to pass on this issue. Compare *Rosenberg* v. *Globe Aircraft Corp.*, 80 F. Supp. 123 (ED Pa. 1948), with *Thiele* v. *Shields*, 131 F. Supp. 416 (SDNY 1955). Cf. 3 L. Loss, Securities Regulation 1787–1791 (1961); 6 L. Loss, Securities Regulation, at 3915–3917 (1969); A. Bromberg, Securities Law: Fraud—Rule 10b–5, § 2.4 (2) (1968).

Sections 11 and 12 of the 1933 Act provide express civil remedies for misrepresentations and omissions in registration statements and prospectuses filed under the Act, as here charged, but restrict recovery to the offering price of shares actually purchased:

> "To impose a greater responsibility would unnecessarily restrain the conscientious administration of honest business with no compensating advantage to the public." H. R. Rep. No. 85, 73d Cong., 1st Sess., 9 (1933).

And in Title II of the Securities Exchange Act of 1934, 48 Stat. 905–908, the same act adopting § 10 (b), Congress amended § 11 of the 1933 Act to limit still further the express civil remedy it conferred. See generally James, Amendments to the Securities Act of 1933, 32 Mich. L. Rev. 1130, 1134 (1934). The additional congressional restrictions, contained in Title II of the 1934 Act, on the already limited express civil remedies provided by the 1933 Act for misrepresentations or omissions in a registration statement or prospectus reflected congressional concern over the impact of even these limited remedies on the new issues market. 78 Cong. Rec. 8668–8669. There is thus ample evidence that Congress did not intend to extend a private cause of action for money damages to the nonpurchasing offeree of a stock offering registered under the 1933 Act for loss of the opportunity to purchase due to an overly pessimistic prospectus.

Beyond the difficulties evident in an extension of standing to this respondent, we do not believe that the *Birnbaum* rule is merely a shorthand judgment on the nature of a particular plaintiff's proof. As a purely practical matter, it is doubtless true that respondent and the members of its class, as offerees and recipients of the

prospectus of New Blue Chip, are a smaller class of potential plaintiffs than would be all those who might conceivably assert that they obtained information violative of Rule 10b–5 and attributable to the issuer in the financial pages of their local newspaper. And since respondent likewise had a prior connection with some of petitioners as a result of using the trading stamps marketed by Old Blue Chip, and was intended to benefit from the provisions of the consent decree, there is doubtless more likelihood that its managers read and were damaged by, the allegedly misleading statements in the prospectus than there would be in a case filed by a complete stranger to the corporation.

But respondents and the members of their class are neither "purchasers" nor "sellers," as those terms are defined in the 1934 Act, and therefore to the extent that their claim of standing to sue were recognized, it would mean that the lesser practical difficulties of corroborating at least some elements of their proof would be regarded as sufficient to avoid the *Birnbaum* rule. While we have noted that these practical difficulties, particularly in the case of a complete stranger to the corporation, support the retention of that rule, they are by no means the only factor which does so. The general adoption of the rule by other federal courts in the 20-odd years since it was pronounced, and the consistency of the rule with the statutes involved and their legislative history, are likewise bases for retaining the rule. Were we to agree with the Court of Appeals in this case, we would leave the *Birnbaum* rule open to endless case-by-case erosion depending on whether a particular group of plaintiffs were thought by the court in which the issue was being litigated to be sufficiently more discrete than the world of potential purchasers at large to justify an exception. We do not believe that such a shifting and highly

fact-oriented disposition of the issue of who may bring a damage claim for violation of Rule 10b–5 is a satisfactory basis for a rule of liability imposed on the conduct of business transactions. Nor is it as consistent as a straightforward application of the *Birnbaum* rule with the other factors which support the retention of that rule. We therefore hold that respondent was not entitled to sue for violation of Rule 10b–5, and the judgment of the Court of Appeals is

Reversed.

SUPREME COURT OF THE UNITED STATES

No. 74–124

Blue Chip Stamps et al., Petitioners, v. Manor Drug Stores, Etc. | On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

[June 9, 1975]

MR. JUSTICE POWELL, with whom MR. JUSTICE STEWART and MR. JUSTICE MARSHALL join, concurring.

Although I join the opinion of the Court, I write to emphasize the significance of the texts of the Acts of 1933 and 1934 and especially the language of § 10 (b) and Rule 10b–5.

I

The starting point in every case involving construction of a statute is the language itself. The critical phrase in both the statute and the rule is "in connection with the *purchase* or *sale* of any security." 15 U. S. C. § 78j (b); 17 CFR § 240.10b–5 (italics added). Section 3a (14) of the 1934 Act, 15 U. S. C. § 78c (a)(14), provides that the term "sale" shall "include any contract to sell or otherwise dispose of" securities. There is no hint in any provision of the Act that the term "sale," as used in § 10 (b), was intended—in addition to its long-established legal meaning—to include an "offer to sell." Respondent, nevertheless, would have us amend the controlling language in § 10 (b) to read:

> ". . . in connection with the purchase or sale of, or an offer to sell, any security."

Before a court properly could consider taking such liberty with statutory language there should be, at least, unmistakable support in the history and structure of the legislation. None exists in this case.

Nothing in the history of the Securities Acts supports any congressional intent to include mere offers in § 10 (b). Moreover, as the Court's opinion indicates, impressive extrinsic evidence in the texts of the two Acts indicates clearly that Congress selectively and carefully distinguished between offers, purchases and sales. For example, § 17 (a), the antifraud provision of the 1933 Act, 15 U. S. C. § 77q (a), expressly includes "offer[s]" of securities within its terms while § 10 (b) of the 1934 Act and Rule 10b–5 do not. The 1933 Act also defines "offer to sell" as something distinct from a sale. § 2 (3), 15 U. S. C. § 77b (3).

If further evidence of congressional intent were needed, it may be found in the subsequent history of these Acts. As noted in the Court's opinion, the Securities and Exchange Commission unsuccessfully sought, in 1957 and again in 1959, to persuade Congress to broaden § 10 (b) by adding to the critical language: "or any attempt to purchase or sell" any security. See *ante*, p. 8.

This case involves no "purchase or sale" of securities.[1] Respondents were mere offerees, who instituted this suit some two years after the shares were issued and after the market price had soared. Having "missed the market" on a stock, they are hardly in a unique position. The capital that fuels our enterprise system comes from investors who have frequent opportunities to purchase, or not to purchase, securities being offered publicly. The market prices of new issues rarely remain static: almost invariably they go up or down, and they often fluctuate

[1] It is argued that the language "in connection with" justifies extending § 10 (b) to include offers which necessarily precede a purchase or sale. The short answer is that the statute requires a purchase or a sale of a security, and no offer was made to respondents in connection with either. Their complaint rests upon the *absence* of a sale to or purchase by them.

widely over a period far less than the two years during which respondents reflected on their lost opportunity. Most investors have unhappy memories of decisions not to buy stocks which later performed well.

The opinion of the Court, and the dissenting opinion of Judge Hufstedler in the Court of Appeals, correctly emphasize the subjective nature of the inevitable inquiry if the term "offer" were read into the Act and some arguable error could be found in an offering prospectus: "Would I have purchased this particular security at the time it was offered if I had known the correct facts?" Apart from the human temptation for the plaintiff to answer this question in a self-serving fashion, the offeror of the securities—defendant in the suit—is severely handicapped in challenging the predictable testimony.[2] The subjective issues would be even more speculative in the class actions that inevitably would follow if we held that offers to sell securities are covered by § 10 (b) and Rule 10b–5.

In this case respondents were clearly identifiable as offerees, as here the shares were offered to designated persons.[3] In the more customary public sale of securi-

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[2] Proving, after the fact, what "one would have done" encompasses a number of conjectural as well as subjective issues: would the offeree have bought at all; how many shares would he have bought; how long would he have held the shares; were there other "buys" on the market at the time that may have been more attractive even had the offeree known the facts; did he in fact use his available funds (if any) more advantageously by purchasing something else.

[3] It is argued that the special facts of this case justify extending the benefit of § 10b–5 to these respondents, even if the statute ordinarily requires a purchase or a sale. But this resolution also would require judicial extension of the terms of the statute. The mere fact that securities are offered to a limited class of offerees may eliminate some of the problems of proof but it does not avoid

ties, identification of those who in fact were bona fide offerees would present severe problems of proof. The 1933 Act requires that offers to sell registered securities be made by means of an effective prospectus. § 5 (b), 15 U. S. C. § 77e (b). Issues are usually marketed through underwriters and dealers, often including scores of investment banking and brokerage firms across the country. Copies of the prospectus may be widely distributed through the dealer group, and then passed hand-to-hand among countless persons whose identities cannot be known. If § 10 (b) were extended to embrace offers to sell, the number of persons claiming to have been offerees could be legion with respect to any security that subsequently proved to be a rewarding investment.

We are entitled to assume that the Congress, in enacting § 10 (b) and in subsequently declining to extend it, took into account these and similar considerations. The courts already have inferred a private cause of action that was not authorized by the legislation. In doing this, however, it was unnecessary to rewrite the precise language of § 10 (b) and Rule 10b–5. This is exactly what respondents—joined, surprisingly, by the SEC—sought in this case.[4] If such a far-reaching change is to

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the fatal objection that no offer of securities, absent a purchase or sale, is covered by the statute.

[4] It is more than curious that the SEC should seek this change in the 1934 Act by judicial action. The stated purpose of the 1933 Act was "[t]o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce . . . ." See preamble to Act, 48 Stat. 74. The evil addressed was the tendency of the seller to exaggerate, to "puff," and sometimes fraudulently to overstate the prospects and earning capabilities of the issuing corporation. The decade of the 1920's was marked by financings in which the buying public was oversold, and often misled, by the bouyant optimism of issuers and underwriters. The 1933 Act was intended to compel moderation and caution in prospectuses, and this is precisely the way that Act has been administered by the SEC

be made, with unpredictable consequences for the process of raising capital so necessary to our economic well-being, it is a matter for the Congress, not the courts.

II

MR. JUSTICE BLACKMUN's dissent charges the Court with "a preternatural solicitousness for corporate well-being and a seeming callousness toward the investing public." Our task in this case is to construe a statute. In my view, the answer is plainly compelled by the language as well as the legislative history of the Securities Acts. But even if the language is not "plain" to all, I would have thought none could doubt that the statute can be read fairly to support the result the Court reaches. Indeed, if one takes a different view—and imputes callousness to all who disagree—he must attribute a lack of legal and social perception to the scores of federal judges who have followed *Birnbaum* for two decades.

The dissenting opinion also charges the Court with paying "no heed to the unremedied wrong" arising from the type of "fraud" that may result from reaffirmance

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for more than 40 years. Precise factual accuracy with respect to a corporate enterprise is frequently impossible, except with respect to hard facts. The outcome of pending litigation, the effect of relatively new legislation, the possible enactment of adverse legislation, the cost of projected construction or of entering new markets, the expenditures needed to meet changing environmental regulations, the likelihood and effect of new competition or of new technology, and many similar matters of potential relevancy must be addressed in registration statements and prospectuses. In administering the 1933 Act, the SEC traditionally and consistently has encouraged and often required offerors to take conservative postures in prospectuses, especially with respect to judgmental and possibly unfavorable matters. If a different philosophy now were to be read into the 1934 Act, inviting litigation for arguably misleading understatement as well as for overstatement of the issuer's prospects, the hazard of "going to market"—already not inconsequential—would be immeasurably increased.

of the *Birnbaum* rule. If an issue of statutory construction is to be decided on the basis of assuring a *federal* remedy—in addition to state remedies—for every perceived fraud, at least we should strike a balance between the opportunities for fraud presented by the contending views. It may well be conceded that *Birnbaum* does allow some fraud to go unremedied under the federal Securities Acts. But the construction advocated by the dissent could result in wider opportunities for fraud. As the Court's opinion makes plain, abandoning the *Birnbaum* construction in favor of the rule urged by the dissent would invite any person who failed to purchase a newly offered security that subsequently enjoyed substantial market appreciation to file a claim alleging that the offering prospectus understated the company's potential. The number of possible plaintiffs with respect to a public offering would be virtually unlimited. As noted above (Part I, n. 2), an honest offeror could be confronted with subjective claims by plaintiffs who had neither purchased its securities nor seriously considered the investment. It frequently would be impossible to refute a plaintiff's assertion that he relied on the prospectus, or even that he made a decision not to buy the offered securities. A rule allowing this type of open-ended litigation would itself be an invitation to fraud.[5]

[5] The dissent also charges that we are callous toward the "investing public"—a term it does not define. It would have been more accurate, perhaps, to have spoken of the noninvesting public, because the Court's decision does not abandon the investing public. The great majority of registered issues of securities are offered by established corporations that have shares outstanding and held by members of the investing public. The types of suits that the dissent would encourage could result in large damage claims, costly litigation, generous settlements to avoid such cost, and often—where the litigation runs its course—in large verdicts. The shareholders of the defendant corporations—the "investing public"—would ultimately

bear the burden of this litigation, including the fraudulent suits that would not be screened out by the dissent's bare requirement of a "logical nexus between the alleged fraud and the sale or purchase of a security."

SUPREME COURT OF THE UNITED STATES

No. 74–124

Blue Chip Stamps et al., Petitioners, *v.* Manor Drug Stores, Etc. | On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

[June 9, 1975]

MR. JUSTICE BLACKMUN, with whom MR. JUSTICE DOUGLAS and MR. JUSTICE BRENNAN join, dissenting.

Today the Court graves into stone *Birnbaum*'s[1] arbitrary principle of standing. For this task the Court, unfortunately, chooses to utilize three blunt chisels: (1) reliance on the legislative history of the 1933 and 1934 Securities Acts, conceded as inconclusive in this particular context; (2) acceptance as precedent of two decades of lower court decisions following a doctrine, never before examined here, that was pronounced by a justifiably esteemed panel of that Court of Appeals regarded as the "Mother Court" in this area of the law,[2] but under entirely different circumstances; and (3) resort to utter pragmaticality and a conjectural assertion of "policy considerations" deemed to arise in distinguishing the meritorious Rule 10b–5 suit from the meretricious one. In so doing, the Court exhibits a preternatural solicitousness for corporate well-being and a seeming callousness toward the investing public quite out of keeping, it seems to me, with our own traditions and the intent of the securities laws. See *Affiliated Ute*

[1] *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (CA2), cert. denied, 343 U. S. 956 (1952).

[2] Just this Term, however, we did not view with such tender regard another decision by the very same panel. See *United States* v. *Feola*, — U. S. — (1975), and its treatment of an analogy advanced in *United States* v. *Crimmins*, 123 F. 2d 271 (CA2 1941).

Citizens v. *United States*, 406 U. S. 128, 151 (1972); *Supt. of Insurance* v. *Bankers Life & Cas. Co.*, 404 U. S. 6, 12 (1971); *SEC* v. *National Securities, Inc.*, 393 U. S. 453, 463 (1969); *Tcherepnin* v. *Knight*, 389 U. S. 332, 336 (1967); *SEC* v. *Capital Gains Bureau*, 375 U. S. 180, 195 (1963).

The plaintiffs' complaint—and that is all that is before us now—raises disturbing claims of fraud. It alleges that the directors of "New Blue Chip" and the majority shareholders of "Old Blue Chip" engaged in a deceptive and manipulative scheme designed to subvert the intent of the 1967 antitrust consent decree and to enhance the value of their own shares in a subsequent offering. Although the complaint is too long to reproduce here, see App. 4–22, the plaintiffs, in short, contend that the much-negotiated plan of reorganization of Old Blue Chip, pursuant to the decree and approved by the district court, was intended to compensate former retailer-users of Blue Chip stamps for damages suffered as a result of the antitrust violations. Accordingly, the majority shareholders were to be divested of 55% of their interest; Old Blue Chip was to be merged into a new company; and 55% of the common shares of the new company were to be offered to the former users on a pro rata basis, determined by the quantity of stamps issued to each of these nonshareholding users during a designated period. Some 621,000 shares were thus to be offered in units, each consisting of three shares of common and a $100 debenture, in return for $101 cash.

It is the plaintiffs' pleaded position that this offer to the former users was intended by the antitrust court and the Government to be a "bargain," since the then reasonable market value of each unit was actually $315. The plaintiffs alleged, however, that the offering shareholders had no intention of complying in good faith with

the terms of the consent decree and of permitting the former users of Blue Chip stamps to obtain the bargain offering. Rather, they conspired to dissuade the offerees from purchasing the units by including substantially misleading and negative information in the prospectus under the heading "Items of Special Interest." The prospectus contained the following statements, allegedly false and allegedly made to deter the plaintiffs from purchasing the units: (1) that "[n]et income for the current fiscal year will be adversely affected by payments aggregating $8,486,000 made since March 2, 1968, in settlement of claims" against New Blue Chip; (2) that net income "would be adversely affected by a substantial decrease in the use of the Company's trading stamp service"; (3) that net income "would be adversely affected by a sale of one-third of the Company's trading stamp business in California"; (4) that "Claims or Causes of Action (as defined) against the Company, including prayers for treble damages, now aggregate approximately $29,000,000"; and (5) that, based upon "statistical evaluations," "the Company presently estimates that 97.5% of all stamps issued will ultimately be redeemed." App. 56.

Plaintiffs alleged that these negative statements were known, or should have been known, by the defendants to be false since, for example, the $29,000,000 in purported legal claims were settled for less than $1,000,000 only three months later, and, as an historical fact, less than 90% of all trading stamps are redeemed. Importantly, when the defendants offered their own shares for sale to the public a year later, the prospectus issued at that time made no reference to these factors even though, to the extent that they were relevant on the date of the first prospectus, one year earlier, they would have been equally relevant on the date of the second. As a result

of the defendants' negative statements, plaintiffs claim that they were dissuaded from exercising their option to purchase Blue Chip shares and that they were damaged accordingly.

From a reading of the complaint in relation to the language of § 10 (b) of the 1934 Act and of Rule 10b–5, it is manifest that plaintiffs have alleged the use of a deceptive scheme "in connection with the purchase or sale of any security." To my mind, the word "sale" ordinarily and naturally may be understood to mean not only a single, individualized act transferring property from one party to another, but also the generalized event of public disposal of property through advertisement, auction, or some other market mechanism. Here, there is an obvious, indeed a court-ordered, "sale" of securities in the special offering of New Blue Chip shares and debentures to former users. Yet the Court denies these plaintiffs the right to maintain a suit under Rule 10b–5 because they do not fit into the mechanistic categories of either "purchaser" or "seller." This, surely, is anomaly, for the very purpose of the alleged scheme was to inhibit these plaintiffs from ever acquiring the status of "purchaser." Faced with this abnormal divergence from the usual pattern of securities frauds, the Court pays no heed to the unremedied wrong or to the portmanteau nature of § 10 (b).

The broad purpose and scope of the Securities Exchange Act of 1934 are manifest. Senator Fletcher, Chairman of the Senate Committee on Banking and Currency, in introducing S. 2693, the bill that became the 1934 Act, reviewed the general purposes of the legislation:

> "Manipulators who have in the past had a comparatively free hand to befuddle and fool the public and to extract from the public millions of dollars

> through stock-exchange operations are to be curbed and deprived of the opportunity to grow fat on the savings of the average man and woman of America. Under this bill the securities exchanges will not only have the appearance of an open marketplace for investors but will be truly open to them, free from the hectic operations and dangerous practices which in the past have enabled a handful of men to operate with stacked cards against the general body of outside investors. For example, besides forbidding fraudulent practices and unwholesome manipulation by professional market operators, the bill seeks to deprive corporate directors, corporate officers, and other corporate insiders of the opportunity to play the stocks of their companies against the interests of the stockholders of their companies." 78 Cong. Rec. 2271 (1934).

The Senator went on to describe the function of each of the many provisions of the bill, including § 9 (c) which, without significant alteration, became § 10 (b) of the Act. He said, as to this section, in terms that surely are broad:

> "The Commission is also given power to forbid any other devices in connection with security transactions which it finds detrimental to the public interest or to the proper protection of investors." *Ibid.*

Similarly, the broad scope of the identical provision in the House version of the bill was emphasized by one of the principal draftsmen, in testimony before the House Committee on Interstate and Foreign Commerce. Summing up § 9 (c), he stated:

> "Subsection (c) says, 'Thou shalt not devise any other cunning devices.' . . . Of course subsection (c) is a catch-all clause to prevent manipulative

> devices[.] I do not think there is any objection to that kind of clause. The Commission should have the authority to deal with new manipulative devices." Testimony of Thomas G. Corcoran, Hearing on H. R. 7852 and H. R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 115 (1934).

In adopting Rule 10b–5 in 1942, the Securities and Exchange Commission issued a press release stating: "The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase." SEC Release No. 3230 (May 21, 1942). To say specifically that certain types of fraud are within Rule 10b–5, of course, is not to say that others are necessarily excluded. That this is so is confirmed by the apparently casual origins of the Rule, as recalled by a former SEC staff attorney in remarks made at a conference on federal securities laws several years ago:

> "It was one day in the year 1943, I believe. I was sitting in my office in the S. E. C. building in Philadelphia and I received a call from Jim Treanor who was then the Director of the Trading and Exchange Division. He said, 'I have just been on the telephone with Paul Rowen,' who was then the S. E. C. Regional Administrator in Boston, 'and he has told me about the president of some company in Boston who is going around buying up the stock of his company from his own shareholders at $4.00 a share, and he has been telling them that the company is doing very badly, whereas, in fact, the earnings are going to be quadrupled and will be $2.00 a share for this coming year. Is there anything we can do about it?' So he came upstairs and I

called in my secretary and I looked at Section 10 (b) and I looked at Section 17, and I put them together, and the only discussion we had there was where 'in connection with the purchase or sale' should be, and we decided it should be at the end.

"We called the Commission and we got on the calendar, and I don't remember whether we got there that morning or after lunch. We passed a piece of paper around to all the commissioners. All the commissioners read the rule and they tossed it on the table, indicating approval. Nobody said anything except Summer Pike who said, 'Well,' he said, 'we are against fraud, aren't we?' That is how it happened." Remarks of Milton Freeman, Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967).

The question under both Rule 10b–5 and its parent statute, § 10 (b), is whether fraud was employed—and the language is critical—by "any person . . . in connection with the purchase or sale of any security." On the allegations here, the nexus between the asserted fraud and the conducting of a "sale" is obvious and inescapable, and no more should be required to sustain the plaintiffs' complaint against a motion to dismiss.

The fact situation in *Birnbaum* itself, of course, is far removed from that now before the Court, for there the fundament of the complaint was that the controlling shareholder had misrepresented the circumstances of an attractive merger offer and then, after rejecting the merger, had sold his controlling shares at a price double their then market value to a corporation formed by 10 manufacturers who wished control of a captive source's supply when there was a market shortage. The Second Circuit turned aside an effort by small shareholders to bring this claim of breach of fiduciary duty under Rule

10b–5 by concluding that the Rule and § 10 (b) protected only those who had bought or had sold securities.

Many cases applying the *Birnbaum* doctrine and continuing critical comments from the academic world [3] followed in its wake, but until today the Court remained serenely above the fray.

To support its decision to adopt the *Birnbaum* doctrine, the Court points to the "longstanding acceptance by the courts" and to "Congress' failure to reject *Birnbaum's* reasonable interpretation of the wording of § 10 (b)." *Ante,* p. 9. In addition, the Court purports to find support in "extrinsic evidence from the texts of the 1933 and 1934 Acts," although it concedes this to be "not conclusive." *Ibid.* But the greater portion of the

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[3] See, *e. g.,* Lowenfels, The Demise of the Birnbaum Doctrine: A New Era for Rule 10b–5, 54 Va. L. Rev. 268 (1968); Boone & McGowan, Standing to Sue Under SEC Rule 10b–5, 49 Tex. L. Rev. 617 (1971); Whitaker, The Birnbaum Doctrine: An Assessment, 23 Ala. L. Rev. 543 (1971); Ruder, Current Developments in the Federal Law of Corporate Fiduciary Relations—Standing to Sue Under Rule 10b–5, 26 Bus. Law. 1289 (1971); Fuller, Another Demise of the Birnbaum Doctrine: "Tolls the Knell of Parting Day?", 25 Miami L. Rev. 131 (1970); Comment, Dumping Birnbaum to Force Analysis of the Standing Requirement under Rule 10b–5, 6 Loyola L. J. 230 (1975); Comment, Standing to Sue in 10b–5 Actions, 49 Notre D. Law. 1131 (1974); Comment, 10b–5 Standing Under Birnbaum: The Case of the Missing Remedy, 24 Hastings L. J. 1007 (1973); Comment, The Purchaser-Seller Requirement of Rule 10b–5 Re-evaluated, 44 Colo. L. Rev. 151 (1972); Comment, Inroads on the Necessity for a Consummated Purchase or Sale Under Rule 10b–5, 1969 Duke L. J. 349; Comment, The Decline of the Purchaser-Seller Requirement of Rule 10b–5, 14 Villanova L. Rev. 499 (1969); Comment, The Purchaser-Seller Limitation to SEC Rule 10b–5, 53 Cornell L. Rev. 684 (1968); Comment, The Purchaser-Seller Rule: An Archaic Tool for Determining Standing Under Rule 10b–5, 56 Geo. L. J. 1177 (1968). See Note, Limiting the Plaintiff Class: Rule 10b–5 and the Federal Securities Code, 72 Mich. L. Rev. 1398, 1412 (1974).

Court's opinion is devoted to its discussion of the "danger of vexatiousness," *ante,* p. 14, that accompanies litigation under Rule 10b–5 and that is said to be "different in degree and in kind from that which accompanies litigation in general." *Ibid.* It speaks of harm from the "very pendency of the law suit," *ante,* p. 15, something like the recognized dilemma of the physician sued for malpractice; of the "disruption of normal business activities which may accompany a law suit," *ante,* p. 18; and of "proof . . . which depend[s] almost entirely on oral testimony," *ibid.,* as if all these were unknown to lawsuits taking place in America's courthouses every day. In turning to, and being influenced by, these "policy considerations," *ante,* p. 12, or these "considerations of policy," *ante,* p. 24, the Court, in my view, unfortunately mires itself in speculation and conjecture not usually seen in its opinions. In order to support an interpretation that obviously narrows a provision of the securities laws designed to be a "catch-all," the Court takes alarm at the "practical difficulties," *ante,* p. 29, that would follow the removal of *Birnbaum*'s barrier.

Certainly, this Court must be aware of the realities of life, but it is unwarranted for the Court to take a form of attenuated judicial notice of the motivations that defense counsel may have in settling a case, or of the difficulties that a plaintiff may have in proving his claim.

Perhaps it is true that more cases that come within the *Birnbaum* doctrine can be properly proved than those that fall outside it. But this is no reason for denying standing to sue to plaintiffs, such as those in this case, who allegedly are injured by novel forms of manipulation. We should be wary about heeding the seductive call of expediency and about substituting convenience and ease of processing for the more difficult task of separating the genuine claim from the unfounded one.

Instead of the artificiality of *Birnbaum*, the essential test of a valid Rule 10b–5 claim, it seems to me, must be the showing of a logical nexus between the alleged fraud and the sale or purchase of a security. It is inconceivable that Congress could have intended a broad-ranging antifraud provision, such as § 10 (b), and, at the same time, have intended to impose, or be deemed to welcome, a mechanical overtone and requirement such as the *Birnbaum* doctrine. The facts of this case, if proved and accepted by the factfinder, surely are within the conduct that Congress intended to ban. Whether these particular plaintiffs, or any plaintiff, will be able eventually to carry the burdens of proving fraud and of proving reliance and damage—that is, causality and injury—is a matter that should not be left to speculations of "policy" of the kind now advanced in this forum so far removed from witnesses and evidence.

Finally, I am uneasy about the type of precedent the present decision establishes. Policy considerations can be applied and utilized in like fashion in other situations. The acceptance of this decisional route in this case may well come back to haunt us elsewhere before long. I would decide the case to fulfill the broad purpose that the language of the statutes and the legislative history dictate, and I would avoid the Court's pragmatic solution resting upon a 20-year-old, severely criticized doctrine enunciated for a factually distinct situation.

In short, I would abandon the *Birnbaum* doctrine as a rule of decision in favor of a more general test of nexus, just as the Seventh Circuit did in *Eason* v. *General Motors Acceptance Corp.*, 490 F. 2d 654, 661 (1973), cert. denied, 416 U. S. 960 (1974). I would not worry about any imagined inability of our federal trial and appellate courts to control the flowering of the types of cases that the Court fears might result. Nor would I yet be disturbed about dire consequences that a basically

pessimistic attitude foresees if the *Birnbaum* doctrine were allowed quietly to expire. Sensible standards of proof and of demonstrable damages would evolve and serve to protect the worthy and shut out the frivolous.